

THE FREEMAN

IDEAS ON LIBERTY



**Richard Cobden:
Creator of the Free Market**

Ethics and Business

**Hollywood's Views of
Capitalism**

The Forgotten Consumer

MARCH 1993

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and about Ludwig von Mises

*Compiled by Bettina Bien Greaves and Robert W. McGee
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Poverty and Freedom

Poverty is an uninteresting subject. Poverty has been, and continues to be, man's standard fate throughout his entire history. The reason is simple. People are poor because they cannot produce much that is valued by others. The intriguing question is why a *tiny* percentage of the world's population, for only a *tiny* part of man's history, has been spared man's usual fate. If we could answer that question, America's wealth could be readily duplicated throughout the world.

While nobody has the complete answer, there are some clues, hunches, and bits of circumstantial evidence. Freedom is the connection. Where we find riches, we tend to find freer people. An examination of Amnesty International's listings of human rights abuses shows a definite pattern where those nations with the least respect for human rights are also the poorest. By contrast, those with the greatest respect for human rights tend to be the richest.

—WALTER E. WILLIAMS

The War on Words

Words—nasty or nice—are never more than passive sparks. Only when there's something to burn can there be a fire. The tantrums you threw as a child, the rage you feel when your expectations are unfulfilled, the angry outbursts that follow stress in your life—these are *learned responses to external events*.

Each of us is responsible not only for how we act, but for how we feel. Yes, as children we were slaves to parental schooling and guidance. Values on our moral menu were instilled in us with little choice or control on our part. But—we don't remain helpless toddlers. Humans have powerful, active centers of volition and reason in their nog-gins capable of discerning good from bad, better from worse. We are educable for life. Childhood emotions and behaviors can be silly, impetuous, and wrong—and they can be changed. We don't have to be jerks just

because Mom and Pop couldn't do a better job.

Anti-hate/harassment ordinances seem now the vogue. City fathers and mothers, with altruistic impatience, try to protect minority sons and daughters from verbal sewage. We reflect: Prohibition failed to control alcohol consumption; the War on Poverty increased welfare lines; the War on Drugs is a horrible political addiction.

And now the War on Words: What will be its impact on freedom of speech? By extension, will we give credence to would-be censors of all forms of communication?

Words will never hurt us like the sticks and stones of bad laws.

—JERRY BOAL

Congressional Reforms

Several recent reforms tend to bias the composition of the Congress in such a way as to be inimical to liberty.

First, with the advent of strict limits on outside income, members of Congress and high government officials appointed to office end up viewing the federal government as their principal source of wealth. This is no doubt a partial explanation for the actions of these officers of the state; laws are passed and regulations are enacted which have the effect of influencing a large number of their constituents to regard the state as their principal benefactor.

Second, full financial disclosure requirements ensure that only persons with a remarkable degree of personal tolerance of government intervention and invasion of privacy will seek or accept high office. It is all too easy for a man to suppose that what interventions and burdens he can tolerate, his neighbors can and ought to bear as well.

Third, campaign spending limitations and public financing of campaigns serve to limit the role of private wealth in elections. This means that fewer persons who have acquired wealth in freedom, and are thus

favorably disposed to economic freedom, will gain office. Invariably, those who do not favor economic freedom favor political redistribution of wealth and the consequent diminution of freedom.

—JOSEPH S. FULDA

Public Employee Pay

Pay for employees of state and local governments rose four times faster than pay for employees in the private sector during the 1980s. By 1989, the average government employee at the state and local level received 9.1 percent more compensation than the average nongovernment employee. From 1980 to 1989:

Average private sector employee compensation increased by 3.4 percent or \$960 annually after adjusting for inflation.

The average increase for employees of state and local governments was 14.6 percent or \$4,031 annually after adjusting for inflation.

Thus, compensation for state and local government employees increased \$4.20 for every \$1.00 of increase in the private sector.

In all but five states, state employees have higher average wages and salaries than private sector employees. Local government employees average more than nongovernment employees in 36 states. During the 1980s:

State government employee wages and salaries grew faster than those for private sector employees in all but four states.

Wages and salaries of local government employees grew faster than those in the private sector in every state but Massachusetts.

Spending for education was not a major factor. Government employees not involved in education saw wages go up 79.2 percent before adjusting for inflation, compared to a 65.8 percent increase for those working in education.

—WENDELL COX

and SAMUEL A. BRUNELLI

"America's Protected Class"

ETHICS AND BUSINESS

by Edmund A. Opitz

A few years ago there was an immensely popular television series, named after Dallas. The central character of this show was a powerful and unscrupulous businessman who got that way by climbing over the backs of rivals, manipulating politicians, and wheeling and dealing with shadowy figures on the fringes of the underworld. J. R. Ewing finally got in the way of a bullet, and for months this nation was racked by the question: "Who shot J.R.?" But the civilized man could only wonder why the trigger man waited so long!

Business and the businessman have had a bad press, almost uniformly. Do you remember the television show whose hero was a businessman? The show that portrayed this businessman as a person of integrity and vision, who labored long hours to produce a product that supplied a genuine need, which he marketed at prices people could afford? Who treated his employees with generosity and consideration, and his customers with unfailing courtesy? Who was a devoted family man, active in civic affairs, and a churchman? Who could recite Shakespeare by the yard, relaxed by listening to his fine collection of recorded symphony music, and could tell a Corot from a Monet? Do you remember that show? Perhaps it was a

movie? Actually it was neither. Such a show was never produced; the subject is taboo, by today's mores.

The businessman has rarely if ever been treated fairly and accurately in drama or fiction. Is this because there are no men and women of superior intellect and high character in the world of business, industry, and trade? Not at all. Has the world of business no dramatic possibilities? Of course it has. But the fictional businessman invariably turns out to be the villain. There is a reason why this is so; the businessman is portrayed as a scoundrel because there is an almost universal bias against business on the part of novelists and dramatists. Businessmen do not get a fair shake because novelists and dramatists—with rare exceptions—have an ideological axe to grind.

This is the impression that emerges from our casual contact with the world of popular entertainment, the world of television, films, and fiction. This impression is confirmed in an unpretentious little volume by Ben Stein entitled *The View from Sunset Boulevard*. Stein interviewed a number of Hollywood writers and producers of television shows in order to find out how they viewed the various aspects of American life. If a visitor from England were to spend a little time watching television, what image of America would he come away with? Stein deals with television's treatment of crime, the police, government, the army, the family, and other aspects of American life, including business. How do the people in

Mr. Opitz, an associate editor of The Freeman, served as a member of the staff of The Foundation for Economic Education from 1955 until his retirement in 1992.

This paper was delivered at St. Mary's University, San Antonio, Texas.

Hollywood regard business? "One of the clearest messages of television," Stein writes, "is that businessmen are bad, evil people, and that big businessmen are the worst of all . . . the murderous, duplicitous, cynical businessman is about the only kind of businessman there is on TV adventure shows, just as the cunning, trickster businessman shares the stage with the pompous buffoon businessman in situation comedies." A well known producer, Stanley Kramer, sees business as "part of a very great power structure which wields enormous power over the people." And beyond that, Kramer implies, there is an "arrangement" between business and organized crime: "the Mafia is part of the entire corporate entity now."

The warped feelings of wealthy and talented Hollywood writers and producers did not spring into existence unaided; it is one of the calculated end results of an intense propaganda effort that has been hacking away at the roots of Western society since the middle of the last century—attacking its religious origin, its values, and what is perceived as the last bastion of the bourgeoisie, business. A scholarly work which meticulously researched this vast literature appeared in 1954, by Professor James Desmond Glover of the Harvard Business School, entitled *The Attack on Big Business*. Professor Glover writes: "In volumes upon volumes of testimony before Congressional committees, in popular novels, in learned treatises and textbooks, in poetry, in sermons, in opinions of Supreme Court justices, 'big business' and its works are seen as evil and attacked. The literature of criticism of 'big business,' and of the civilization it has done so much to bring into being, represents by now a perfectly staggering mass of material."

The Anti-Capitalistic Mentality

What is the rationale for this widespread antagonism toward the business system, otherwise known as capitalism? I don't profess to understand all the reasons for the anti-capitalistic mentality, but the root

cause of the antipathy is surely the perception, the mistaken perception, that the relation between employer and employee is that of exploiter to victim. The employer may intend no harm, he may intend only good to those who work for him, but in the capitalistic mode of production—Karl Marx contended—the worker is denied the full fruits of his labor; a portion of every wage earner's product is garnished by his boss. To simplify Marxist theory, we might say that John Smith—who runs a machine in a shoe factory—punches the clock at eight o'clock in the morning and works till noon. During these four hours he produces six pairs of shoes, which represent his wage for the day. John Smith returns to his bench and works four more hours in the afternoon, but the shoes he produces during these four hours are expropriated by his employer.

This is a summary statement of the surplus value theory, otherwise known as Marx's exploitation theory. It is a central contention of Marxism that labor alone creates value, the value of a commodity being measured by the quantity of labor normally necessary to produce it. But if it is labor alone that creates value, the value created should belong exclusively to labor. It does not, however; the lion's share is grabbed by the employer while the real producer is paid only a subsistence wage.

This theory overlooks the role of tools and machinery in production. The tool user in this generation is many times more productive than his counterpart of a few generations ago. Why is this? His naked labor power is no greater than that of people over the ages. The enhanced productivity of labor today is due to the tools and machinery at the disposal of every one of us—and those tools are the fruits of the labor of earlier generations. If today's "worker" retained the full product of his individual effort, and only that, the poor fellow would starve.

A contemporary of Marx, the celebrated Austrian economist Eugen von Böhm-Bawerk, demolished the surplus value theory in a book entitled *Capital and Interest*, published in 1884, the year after Marx died. The demolition job has been repeated many

times since the appearance of Böhm-Bawerk's great book, and the consensus of opinion among independent economists is that the surplus value theory does not hold water. The exploitation theory has great propaganda value, however, and it is used unthinkingly by those who are acting out a grudge against business, which, in their distorted vision, keeps the poor locked in their poverty in order that others might be rich.

Ben Stein, in the book mentioned earlier, records a portion of his conversation with television writer Bob Weiskopf:

"Q. Why are people poor in America?

"A. Because I don't think the system could function if everyone was well off.

"Q. What do you mean?

"A. I think you have to have poor people in a capitalist society.

"Q. Why?

"A. To exploit. The rich people can't exploit each other. Consequently they always exploit the poor."

It is not only Hollywood script writers who profess to believe that the rich get richer only by making the poor poorer. The coordinator of the National Council of Churches' Anti-Poverty Task Force asserts that, "Poverty would not continue to exist if those in power did not feel it was good for them." A moment's reflection will reveal this insulting accusation for the silly sentiment it is. We live in a commercial and manufacturing society. Our economy is featured by mass production, not only in factories but also in agriculture. The products of mass production flood our stores and supermarkets and showrooms, to be bought by the mass of consumers. Mass production cannot continue unless there is mass consumption; and the masses of people cannot consume the output of our mass production factories and fields unless they possess purchasing power—the money to buy the goods of their choice. To suggest that those who have goods and services to sell have some sinister interest in keeping their potential customers too poor to buy is sheer nonsense! If the president of General Motors wants to sell you a Cadillac or a Buick or a

Chevrolet—which he does—then he wants you to be rich enough to buy. In the free economy, everyone has a stake in the economic well-being of every other person.

It is in the immediate interest of business and businessmen that the masses of people be well off; people who are poor are poor customers, and business cannot survive without customers. Business has no stake in poverty; but there is a class of people who do need the poor, who do have an interest in keeping them poor. Permit me, in a slight digression, to offer you a few words on this point by the celebrated economist Thomas Sowell: "To be blunt, the poor are a gold mine. By the time they are studied, advised, experimented with and administered, the poor have helped many a middle class liberal to achieve affluence with government money. The total amount of money the government spends on its 'anti-poverty' efforts is three times what would be required to lift every man, woman, and child in America above the poverty line by simply sending money to the poor."

Back now to the widespread animus against business, stemming from the false idea that labor is the sole source of value but is not allowed to keep what it produces. In the distorted vision of Karl Marx, business, industry, and trade—as these economic activities are organized in the free world—are intrinsically evil, and the businessman is a parasite and predator. Similar notions are entertained by many a man in the street who has never read a line of Marx, as well as by intellectuals who regard themselves as anti-Communists. Given this climate of opinion, the term "ethical businessman" is a contradiction in terms; it is the figure of speech known to English teachers as an oxymoron—a figure which juxtaposes incongruous terms like "virtuous thief" or "honest liar."

Now, if businessmen are involved in activities which are intrinsically crooked, evil by their very nature, then it is pointless to discuss the ethical situations of business or the moral dilemmas businessmen sometimes face. It would be like instructing a thief on how to rob banks honestly! So I propose to spend a few minutes trying to

understand the nature of the economic activities that engage businessmen, while touching upon some of the values that are implicated in the production of goods and services.

All Are Sinners

You have a right to know the direction from which I am coming at you, to know my bias. I have examined the catalogue of sins of which businessmen are allegedly guilty, and Lo! they are the very same sins exhibited by people in every other walk of life. We all break the Commandments now and then, every one of us. Businessmen have no monopoly on sin. My mind goes back to a conversation I had several years ago with a professor of economics with years of teaching behind him, who had also served for many years as the academic dean of a prestigious midwestern college. He said to me, "You know, Ed, a thoroughly dishonest man can last a lot longer in teaching or preaching than as a used car salesman." There may be some hyperbole here, but my friend has a point. There are good and bad in all walks of life, and there are very few saints anywhere; but in the eyes of the law all are equal. The law should mete out justice upon the guilty party with impartiality. It should punish those who harass, steal, defraud, breach a contract, assault, or murder. This is the rule of law in action.

There is no justification for the assumption that all businessmen are evil people who must therefore be regulated, i.e., adjudged guilty until proven innocent. There is no more reason for regulating businessmen than for regulating clergymen or teachers!

Who Decides?

The free market economic system produces goods and services in abundance, and it rewards every participant according to his individual contribution—as his peers judge that contribution. "To the producer belongs the fruits of his toil," is an ancient bit of wisdom, as true now as when first uttered. The relation between an individual's effort

and the eventual reward of his exertions is fairly clear in a simple situation like subsistence farming. You work by yourself, preparing the ground in the spring, seeding and tilling it, watering the furrows with your sweat during the heat of summer, reaping in the fall. The abundance of your harvest is directly traceable to your skills and the amount of work you put forth. The greater your effort the more ample your harvest—other things being equal. The harvest is your wage, and your wage in this instance is pretty much determined by your own skill and your own exertions; the more you put in the more you will take out. What you take out is your wage, the economic equivalent of your contribution.

How is your wage determined in a complex division of labor society such as ours? Justice still demands that every participant in the economy be rewarded according to his contribution to the productive process. But how shall we identify each individual's contribution in order to reward him commensurately? Economists from Adam Smith to Ludwig von Mises to F. A. Hayek and Milton Friedman have worked this question over and come up with an answer that is completely democratic and economically efficient, while encouraging every person in the full exercise of his lawful liberties. The answer provided by the economist is: Let the market decide what each person's contribution is worth and reward him accordingly. "The market" describes the process of social cooperation under the division of labor where free people specialize in a complex variety of tasks in anticipation of a consumer demand for the goods and services they produce—followed by multiple voluntary exchanges of these products in which persons give over something they value for whatever they value more. This market process will reward people unequally, but it will reward them equitably, compensating each person in a measure equal to his peers' evaluation of his services.

The eminent economist Frank H. Knight, founder of the Chicago School, put the matter in these words: "It is a proposition of elementary economics that ideal market

competition will force entrepreneurs to pay every productive agent employed what his cooperation adds to the total, the difference between what it can be with him and what it would be without him. This is his own product in the only meaning the word can have where persons or their resources act jointly." In short, each person will get his fair share, defined as what others will voluntarily offer for his goods and services—provided there is general freedom.

Each one of us is judged by his peers; our offerings of goods and services are evaluated by consumers who give us what they think our offerings are worth to them, and not a penny more. This is a democratic judgment on the value of the products of our labor—one dollar, one vote—and it is made by consumers who are, as everyone knows, ignorant, venal, superstitious, neurotic, biased, and stupid. In other words, people just like us—because every one of us is a consumer! When it is a question of the wage we earn we are dependent on consumers, who couldn't care less that we are upright men of sterling character; their sole concern is: Do we have a product or service they want? If we do, they reward us handsomely. If we don't, it matters not that we have labored long and painfully over our brainchild; if the customers don't want it, we're stuck with it. This is consumer sovereignty.

Consumers run the free economy; producers cater to their demands. It's their show. What kind of a show do they put on? Not always a good one, I'm sorry to say. But I'll say one thing for consumer sovereignty: it sure beats the alternative.

Freedom to Excel and Fail

Freedom is a costly thing, and we cannot keep it unless we are willing to pay the price. It is required of each one of us that we firmly adhere to the processes of freedom, even when we can barely stand some of the products of freedom—the products being what people do when given their "druthers." The freer the society the more things people will do that we might find distasteful; this is one of the consequences of freedom,

and we have to school ourselves to accept it. This we have learned to do in two important areas—freedom of the press and freedom of worship. We must learn to be equally tolerant in the areas of business, industry, and trade.

How fares the written word when the masses are relatively literate and free to pick their own reading material, where they themselves select the men and women who will do their writing for them? The highest paid writers may be those whose subliterate efforts jam the boob tube, some of whose opinions I quoted earlier. The magazines and newspapers of largest circulation may be those which cater to our prurient interests. Best-selling novels are forgotten by next year. But as much as anyone might deplore the decline of reading and the low estate of publishing—now that the press is free—no one with any sense would wish to add a Department of Censorship to the already overgrown government bureaucracy. To put the press under a Ministry of Information and Propaganda would be disastrous. Freedom of the press may give every idiocy a voice; authors may not reap a monetary reward commensurate with their literary talents; so be it, we say; it's the price we pay willingly for freedom of the press. Freedom merely allows the budding genius the elbow room he needs to live, and breathe, and write. And books of solid scholarly competence still appear regularly for the small audience which needs the nourishment only the word can provide. My mind goes back to an observation of Ralph Waldo Emerson: "There are not in the world at any one time more than a dozen persons who read and understand Plato:—never enough to pay for an edition of his works; yet to every generation these [works] come duly down, for the sake of those few persons . . ."

Take the matter of religious liberty, the separation of church and state. In a free society people are not punished for belonging to the "wrong" church. They belong to the church of their own choice, or they belong to no church, as the case might be. In any event, the law pays no attention, so long

as no injury is done to person or property. What happens when people are free in the area of religion? First of all, they mangle the phrase "separation of church and state" into my least favorite American shibboleth! Even people who should know better distort and misuse the phrase.

Then there are the so-called "electronic churches," the spellbinders who appear in television; there are the "hot gossellers" who dominate radio every Sunday morning; there are the cults in which people give over their souls to some figure of dubious charismatic allure; there is the new appeal of mystical imports from the exotic Orient; the occult flourishes, along with magic and superstition. And the mainline churches, in many instances, have subordinated theology to dubious economic and political theory. Church bodies support and help finance revolutionary and guerrilla activities. But is anyone campaigning to establish a government Department of Religion? Not to my knowledge. However much we may dislike certain manifestations of religion when belief is free, we shrug our shoulders and tolerate what we dislike as the price of religious liberty.

Some of these same considerations apply to the realm of business, industry, and trade, where, as H. L. Mencken once wryly observed: "Nobody ever went broke by underestimating the taste of the American public." This is all too obvious in what is called the entertainment industry. Here is a hyperkinetic young man, lacking in musical sense, who makes eight million dollars a year by howling and gyrating in public places. Here's another young man, gifted with a high musical I.Q. and years of study behind him. A handful of people appreciate his organ virtuosity and his sensitive interpretation of Bach. He earns a living as a bank teller, directs a choir, and gives an occasional free organ recital. Young people pay millions of dollars to hear the Rolling Stones, while the Boston Symphony has to pass the hat in order to survive. Is this fair? No. Is it a matter for political solution? That would be an even greater travesty of justice.

The Market Economy

Human beings everywhere have engaged in trade and barter. There is some specialization and a division of labor even among primitive people, with a consequent exchange of the fruits of specialization. The voluntary exchange of goods and services is the market in operation, and the market is everywhere. But the market does not spontaneously or automatically transform itself into the market economy; the market economy emerges only when the moral, political, and legal conditions are right. This occurred under the Whig philosophy of men like Edmund Burke and Adam Smith, Thomas Jefferson and James Madison. These men drew up a frame of government whose main purpose was to secure each person in his life, liberty, and property. This political idea of limited, constitutional government is grounded on the religious conviction that we are God's creatures, possessing immortal souls. The conviction that persons are sacred is politically translated into our Creator-endowed rights to "life, liberty, and the pursuit of happiness." Adam Smith referred to his "liberal plan of liberty, equality and justice," with the free market as the economic counterpart to political liberty. The rule of law replaces the arbitrary will of rulers and personal freedom expands. It is significant that *The Wealth of Nations* appeared in the same year as the Declaration of Independence.

The discipline of economics as a separate subject matter was almost non-existent prior to Adam Smith. Virtually starting from scratch, Smith created nearly the whole edifice of economics. Adam Smith presupposed the legal framework of the Whig jurists, where the law would eliminate force from the marketplace, punish fraud, and enforce contracts. He also presupposed a high level of probity in the general population. Given these conditions, the market is self-starting and self-regulating; the buying habits of consumers guide producers, determining how the entrepreneur will decide to combine scarce resources for the maximum satisfaction of consumer needs. There will

be a harmony in these diverse activities of millions of participants as if everything were directed by "an invisible hand." The market economy—dubbed "capitalism" by its enemies about a century after Smith—contained the promise of prosperity for the multitudes. These same masses composed a self-governing people. Political liberty expanded and people had lots of elbow room to pick and choose and plan their own lives.

The Declaration and the Constitution created the political frame for a people who aspired to the ideal of "liberty and justice for all." Political liberty assured freedom in economic transactions between employer and employee, seller and buyer. The work ethic was enshrined in America and wages doubled, redoubled, and doubled again during the nineteenth century—an eightfold increase in real wages. For the first time in history the masses glimpsed the possibility of pulling themselves out of poverty and creating new opportunities for their children. America's schools and churches sought to shore up the traditional value structure of our culture and to orient the newly enlarged popular freedom toward virtue. Their success, needless to say, was only partial.

Was there ugliness in American life? Of course there was. Freedom was misused; the scramble for wealth was sometimes pretty crass. The newly rich were vulgar; plunderers bought and sold politicians, and fortunes were scooped out of the public treasury—all in violation of Whig theory and free market economics. But you cannot blame capitalism for the miscreants who refuse to abide by its rules.

Despite the gray and black areas in our history, there was still open opportunity on these shores, in comparison to what was available in other parts of the globe. Thirty-three million people told us so by coming here as immigrants during the half century before World War I. They came because life here—although far from perfect—was far better for them than life elsewhere.

The business of America is not business. It never was. The business of America is individual liberty, with the law enforcing an

even-handed justice among equal persons. When the law provides a free field and no favor—which was the original implication of *laissez faire*—the economic order is the free market.

The market economy does not carry any implication that business may act irresponsibly with impunity. If, for example, industrial wastes are disposed of in such a way that persons are injured or property damaged, the law should punish those responsible and offer redress to the injured party. If a seller misrepresents a product he is guilty of fraud and the buyer's injury should be redressed. If a businessman solicits and obtains a subsidy from government, or if government gives him monopolistic advantages over his competition enabling him to exact a higher price from his customers, he has forfeited his status as a businessman. A businessman as such has no power over anyone, his only leverage being the quality of his goods and the persuasiveness of his advertising. The businessman has the same rights and the same responsibilities as every other member of society, no more and no less.

Lord Acton's aphorism about power has been overquoted, but it is still terribly true. Power must be curbed if we will that people shall be free, and an independent economic order does put fetters on governmental power. People who control their own livelihood have little to fear from rulers; but political control of the economic life of a nation is totalitarian rule. The market economy curbs power in another way as well; it channels the activities of energetic, ambitious, and competitive personalities into the production of goods and services and away from politics. The rich in a free economy get that way because consumers appreciate the goods and services they offer; and if these few wish their descendants to enjoy this wealth the bulk of it must be invested in industries producing goods for the masses.

The End of Liberty

Let us give credit where credit is due; business, industry, and trade have made us into a prosperous nation. But our wealth has

not made us a happy nation, or a contented one. We have proved once again—as if any further proof were needed—that prosperity and worldly success are, at best, a means to ends beyond themselves. Refine and improve a means as you will, it still remains only a means, needing a worthy end if it is to be meaningful. There is a discipline that deals with ends and goals, with the purposes that make life significant; it is called religion—though not everything bearing that label qualifies. But genuine Christianity is at a low ebb in the modern world; we have lost that vital contact with God and the moral law which energized our ancestors and made life for them an adventure in destiny. The decadence of Christianity is the root cause of the modern malaise; Plato argued two millennia ago that disorder in society is a reflection of disorder in the soul, that is, in

our defective thinking and misguided loyalties. The work of renewal must begin here, with individual persons, and then go on to a restoration of the theological foundation necessary to a free society.

This is not the task of business, industry, and trade; the economic order has a more humble role to play. Business and the free economy beget a prosperous society which provides people the leisure they need to cultivate those goods which mark a high civilization: religion and worship, education and science, arts and crafts, conversation and play. These are the areas where people exercise their freedom most creatively, where they discover the goals proper to human life. Responsible freedom in the economic realm has the important role of supplying the indispensable means for these ends. □

RELIGION AND CAPITALISM: ALLIES, NOT ENEMIES

SPECIAL
REPRINT
EDITION

by Edmund A. Opitz
with a new foreword by Robert A. Sirico

In the late 1960s Arlington House Publishers commissioned Edmund A. Opitz of the FEE staff to write a book-length exploration of the relationship of biblical religion to free market economics. The resulting volume, *Religion and Capitalism: Allies, Not Enemies*, was published in 1970 as a Conservative Book Club selection.

Typical of the response to the book's publication was M. Stanton Evans' comment in *National Review*: "Opitz' volume is a major refutation of the Christian-Socialist, social-gospel view that has become so dominant in Western religious thought....[T]he Opitz book, with its unusual combination of economic knowledge and vigorous theism, is a major breakthrough in the scholarship of freedom."

Edmund Opitz, an ordained Congregational minister, is the founder and coordinator of The Remnant, a fellowship of conservative and libertarian ministers, a founder and secretary of The Nockian Society, and an associate editor of *The Freeman*. He served as a member of the staff of FEE from 1955 until his retirement in 1992.

In reprinting *Religion and Capitalism*, FEE honors the notable accomplishments of Edmund Opitz, and preserves an intellectual legacy for a future generation of Christian scholars.

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HOLLYWOOD'S VIEWS OF CAPITALISM

by Raymond J. Keating

Although the movie industry has certainly thrived under the free enterprise system, Hollywood is often unfriendly in its cinematic portrayals of businessmen and capitalism, though there are some exceptions. A visit to your local video store reveals a disagreement among film makers over what capitalism represents. I recently rented movies by three prominent directors—Oliver Stone, Francis Ford Coppola, and Frank Capra. The contrasts were stark, especially between Stone and the latter two.

Oliver Stone's *Wall Street* leads the movie-goer to believe that the securities industry is a rigged game, and that capitalism is inherently corrupt. Hard work as a means to success in the financial community is debunked, only to be supplanted by corruption and law breaking, as securities trading is seen as a game with little or no productive value. Stone presents a harsh judgment on an economic system he fundamentally misunderstands.

Wall Street has come to be the historical revisionists' cinematic representation of the 1980s—the so-called “decade of greed.” It, unfortunately, offers a view prevailing not only in the film industry, but in academia and the media as well. In many ways, *Wall Street* perpetuates a class warfare myth, with contrasts being drawn between so-

called haves and have nots, or the bourgeoisie and the proletariat.

The movie's antagonist is Gordon Gekko, a corporate raider. Gekko's speech at the stockholders meeting of Teldar Paper, his takeover target, is meant by Stone to reflect the corrupt nature of capitalism. In fact, Stone managed—knowingly or not—to provide a glimpse of why corporate raiders provide a *positive* service in a free market economy. Gekko states:

Teldar Paper has 33 different vice presidents, each making over \$200,000 a year. . . . Our paper company lost \$110,000,000 last year, and I'll bet half of that was spent in all the paperwork going back and forth between all these vice presidents. The new law of evolution in corporate America seems to be survival of the unfittest. . . . I am not a destroyer of companies; I am a liberator of them. The point is, ladies and gentlemen, that greed—for a lack of a better word—is good. Greed is right. Greed works. Greed clarifies, cuts through, and captures the essence of the evolutionary spirit. Greed, in all of its forms, greed for life, for money, for love, knowledge, has marked the upward surge of mankind. And greed—you mark my words—will not only save Teldar Paper, but that other malfunctioning corporation called the United States of America.

Raymond J. Keating is New York State Director of Citizens for a Sound Economy.

Greed or Self-Interest?

The word “greed” in such a speech is Stone’s carrier of corruption. It is his word of choice designed to elicit a specific response from the movie-going audience. After all, how could one view greed favorably? In fact, “self-interest” would have been a more apt term, which was understood over two centuries ago by Adam Smith, the father of capitalism. Smith wrote in *An Inquiry into the Nature and Causes of the Wealth of Nations*: “It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest.” Self-interest removes the judgmental nature of Stone’s presentation, while encompassing not only greed, but also industry, charity, self-improvement, and altruism—i.e., any human motivation.

Gekko’s later statements lend greater clarity to Stone’s view of the world. In reference to a Gekko plan to liquidate the holdings of an airline company, Budd Fox (the movie’s symbol of redemption as he in the end rejects the greed Gekko represents) asks, “Why do you need to wreck this company?” Gekko’s answer: “Because it’s wreckable!” Stone views the breakup of a firm as pure destruction. He is unable to understand what Joseph Schumpeter termed “creative destruction.” That is the notion that resources might be more efficiently used if freed from less profitable ventures and reinvested elsewhere. This is the dynamic aspect of capitalism that allows for renewal and growth.

But the essence of Stone’s limited vision is captured in Gekko’s definition of capitalism: “It’s a zero sum game. Somebody wins, somebody loses. Money itself isn’t lost or made, it’s simply transferred from one person to another—like magic. This painting here, I bought it ten years ago for \$60,000. I could sell it today for \$600,000. The illusion has become real, and the more real it becomes, the more desperate they want it. Capitalism at its finest. . . . I create nothing. I own. . . . You’re not naive enough to think that we live in a democracy, are you, Buddy? It’s the free market.”

Stone does not understand that wealth can be created, not merely shifted around, and that the free market provides the incentives for individuals to create, innovate, and take risks. He sees a rise in the price of a painting as the pinnacle of capitalism. In fact, it is in those nations that have rejected free enterprise where the only source of value is to be found in a painting, for little else is created.

Wall Street presents a view of capitalism as being controlled by the few at the expense of the many—democracy versus the free market in Gekko’s words. Stone does not understand the nature of an exchange economy, missing a fundamental point that in a free enterprise system, one must first supply a service or good in order to demand; i.e., even the most greedy individuals must supply something that fulfills the needs or wants of another individual in order to participate in an exchange economy. Individuals vote with their dollars, if you will. The phrase “democratic capitalism” seems quite natural, for example, while “democratic socialism” seems oxymoronic.

A Man and His Dream

In direct contrast to *Wall Street* is Francis Ford Coppola’s *Tucker: The Man and His Dream*. I will not venture here to analyze the historical accuracy of this film about Preston Tucker. It is the message that concerns me. While Stone views the fundamental conflict in a capitalist system as being between rich and poor, *Tucker* presents a more accurate conflict—between a partnership of big government and big business versus the entrepreneur, or entrenched interests versus dynamic change.

Tucker is the story of a man who sought to build a better automobile, and therefore challenged Detroit’s Big Three auto makers. As Tucker exclaims, “That’s the whole idea—to build a better mouse trap.” His partner’s response—“Not if you’re the mouse”—signals the ongoing conflict. *Tucker* illustrates how a special interest seeks government protection from the forces of competition, i.e., from the forces exerted by innovators and risk takers. It

brings to life the clash between the bureaucratic mind and the entrepreneurial.

One character representing old-guard bureaucrats states: "A well-run corporation doesn't waste money to research innovations, unless of course, keeping up with the competition demands it."

In contrast, Preston Tucker's closing speech expresses the critical role of entrepreneurship:

We invented the free enterprise system where anybody, no matter who he was, where he came from, what class he belonged to, if he came up with a better idea about anything, there was no limit to how far he could go. I grew up a generation too late I guess because now the way the system works, the loner, the dreamer, the crackpot who comes up with some crazy idea that everybody laughs at that later turns out to revolutionize the world, he's squashed from above before he even gets his head out of the water because the bureaucrats, they'd rather kill a new idea than let it rock the boat. If Benjamin Franklin were alive today, he'd be thrown in jail for sailing a kite without a license. . . . if big business closes the door on the little guy with the new idea, we're not only closing the door on progress but we're sabotaging everything we fought for, everything the country stands for.

Tucker: The Man and His Dream tacitly acknowledges that wealth can be created, and that the entrepreneur is the driving force of wealth creation and economic growth. Such entrepreneurship is evident in practically all aspects of a free enterprise system, including the securities industry which *Wall Street* condemns. For example, various financial instruments that provide for liquid markets and allow both small and large firms to raise financial capital are the products of hard-working entrepreneurs (junk bonds included). Not to mention that entrepreneurship is quite evident in the insights of many corporate raiders who are able to see added value where others cannot.

The two views of government presented in *Wall Street* and *Tucker* are instructive as

well. In *Wall Street*, stock market regulators act as saviors, cleaning up what unbridled capitalism has wrought. In *Tucker*, the Securities and Exchange Commission does the bidding of powerful politicians and special interests in crushing the entrepreneur.

Frank Capra's America

In the end, perhaps it was movie director Frank Capra who saw things most clearly. Few free market advocates can suppress a smile when viewing the scene from *You Can't Take It With You* in which Lionel Barrymore's character, Mr. Vanderhoff, gives an IRS agent a hard time. The playful exchange includes the following:

IRS AGENT: "Our records show that you have never paid an income tax."

VANDERHOFF: "That's right."

IRS AGENT: "Why not?"

VANDERHOFF: "I don't believe in it."

And later, it continues:

VANDERHOFF: "What do I get for my money? . . . I wouldn't mind paying for something sensible."

IRS AGENT: "Something sensible. What about Congress and the Supreme Court and the President? We gotta pay them, don't we?"

VANDERHOFF: "Not with my money."

Capra often brought out America's healthy skepticism of big government in his movies (*Mr. Smith Goes to Washington* is one example). However, in *It's a Wonderful Life*, Capra truly presented a wide range of human behavior. Some individuals, like Mr. Potter (again Lionel Barrymore), stole and sought to monopolize, while others, Jimmy Stewart's George Bailey, sacrificed for others while still seeking a better life for his family. It is the individual who must take ultimate responsibility for his actions.

The free enterprise system is not inherently corrupt. In fact, it is morally superior to other economic systems, not only because it is the most productive—lifting individuals out of squalor—but because it is based on free, individual action. When compared with the centralized, coercive nature of socialism, it is clear that capitalism does



Frank Capra (right) on the set of "Mr. Smith Goes to Washington" with Jean Arthur and Jimmy Stewart.

provide for a wonderful life, where individuals can make the most of their abilities. It is only when government steps in the way that the dynamic, creative nature of the free enterprise system is stymied. Yet, even as Preston Tucker's automobile company was brought down by special interest and big

government, the final scene of *Tucker: The Man and His Dream* has Tucker, the innovator, sketching a new idea for little kerosene refrigerators that would allow even the poorest of people to keep milk cold. One might say that is truly "Capitalism at its finest." □

The Role of Proper Conduct

“**B**USINESS” is a product of civilization and it cannot exist for long in the absence of a specific constellation of conditions, chiefly moral, which support our civilization. The economic ingredient in the constellation is, as we shall see, free competition. But free competition cannot function unless there is general acceptance of such norms of conduct as willingness to abide by the rules of the game and to respect the rights of others, to maintain professional integrity and professional pride, and to avoid deceit, corruption, and the manipulation of the power of the state for personal and selfish ends.

—WILHELM ROEPKE

IDEAS
ON
LIBERTY



AMERICA'S IMPENDING BRAIN DRAIN

by Fulton Huxtable

Most commentators on the subject of what lies in the future generally begin—and end—their discussion by citing facts and figures concerning the demographic makeup of the population of the United States.

They will, for instance, point to the declining birth rate of the past 30 years, and correctly draw the conclusion that there will be fewer persons entering the labor market between now and the year 2000. Such commentators might also point to the alarming, steady decline in the test scores of our students and conclude that there will be fewer workers with the needed basic skills entering the market in the next few years.

While all of this is true and instructive enough, the threat to this country's future brainpower—our prospective engineers, scientists, and professionals of every type—is far more serious and far more insidious than most imagine. Many individuals are not even aware of the process which is gradually destroying the minds of so many of today's young people.

A Child of the '40s

To help you see what has happened in this country, let me briefly recount the story of someone I have known all of my life. This goes back nearly 50 years to 1943, when this

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person began his life. The world then was quite, quite different from the one he would grow up in if he were born today.

This boy grew up in a small, rural community in Arkansas and in a family of modest means. He listened to Sky King and Sergeant Preston on the radio. He went to the local movie theater nearly every Saturday to see Roy Rogers, Gene Autry, and all the other heroes of the big screen. This boy *idolized* these people. When he grew up, he wanted to be just like them, to be heroic and do important things in life.

When television came to the household in the mid-'50s, he loved to watch Superman and the other heroes. Again, he wanted to be like them. They inspired him to try to make something out of himself.

In school, he was a good student and it was important to him to learn and do well. He had good teachers who encouraged him.

Life suddenly changed for this kid, at the age of 14, when his father went broke, losing virtually everything. His father lost the home he had owned, the family car was repossessed and, before it was over, the lights in their rented house were periodically turned off because the electric bill hadn't been paid.

But the boy, remembering his heroes, faced the fears brought on by suddenly not having money and went to work. He did everything: he got up at 3:30 in the morning to deliver papers, he mowed yards, he ran

the popcorn stand at the local dime store, he drove a tractor for one of his Dad's friends, and had more jobs in high school than there is room to write about.

He excelled in high school, despite the hardships and the fact that he was the oldest of seven kids, growing up in a small, three-bedroom home. He was absolutely determined to get an education, because he saw education as the key to his future, as the way to get out of the grinding poverty. He worked his way through both undergraduate and graduate school and eventually went on to establish his own business and achieve a fair degree of success.

A Child of the '70s

Now, consider how this same person might have turned out, today, if he were born in, say, 1970. What might make things turn out differently?

Well, let's try to recall the kinds of movies and television programs during the early '70s. By that time, the heroes of the late '40s and '50s had disappeared, replaced by what were openly called anti-heroes who possessed none of the admirable qualities projected by heroes. Heroes were made laughable, silly, and the objects of ridicule in both television and in the movies.

Broadly speaking, a hero is someone who is committed to doing what is right and has the courage to act according to his convictions. Such an image is important to children (and to adults), because it provides us with a vision of what one should be as a person. Some specific heroic qualities, such as courage, honesty, and integrity, are essential for a young person to learn. And, as one grows up, one learns that it isn't necessary to chase criminals to be a hero. It is the *principle* which is important to learn: do what you think is right, struggle to achieve something important.

Now, would that young man, born in 1970, rather than in 1943, develop an heroic vision of what his future life should be? It isn't likely and, if he did, he certainly couldn't have gotten it from the movies and television programs of the '70s and '80s.

And what might he have done if, say, in 1984, his father had gone broke? Would he, a 14-year-old, have struggled and endured unspeakable hardships to work at every job he could get in order to make it? Maybe, but again, it isn't likely. In 1984, the government offered food stamps, housing assistance, and all sorts of other things to supposedly take the sting out of poverty. Never mind that such programs create a class of people who become dependent on the government, that they destroy self-reliance as a virtue in our young people and actually *perpetuate poverty* because people never learn how to take care of themselves.

Why should that young man, born in 1970, make the excruciating struggle to get an education and rise above his poverty, if nothing is important in life, if there isn't anything worth the struggle (the lesson conveyed by the anti-heroes), and if the government will take care of his needs anyway? Increasing numbers of our young people are deciding there isn't any point to making the struggle.

And lest anyone think I am hardhearted and "don't understand" what it's like to be poor and uneducated, let me tell you that I am the kid born back in 1943 and his story is my story.

Don't misunderstand me: each person has a choice about what he or she will be. A few individuals manage, somehow, to buck the bad trends of their particular era. However, the sad fact is that most young people follow the prevalent values of their time. If the prevailing view is that being a hero is silly, old-fashioned, and out of touch with reality, believe me, most young people will not try to be heroic and will not struggle to achieve something important in their lives.

The anti-heroic view so prevalent in the '70s and '80s (and which continues to this day) wasn't confined merely to television and the movies; it has permeated *every* cultural outlet: books, novels, plays, music (especially the kids' music) and, worst of all, *our teachers*.

If a young person, born in 1970, has managed to achieve and preserve any heroic sense, any belief in such things as truth,

certainty, and political freedom, he or she may well encounter a brutal assault on those beliefs in college.

In college, his teachers will claim that there are no absolutes (but they are certain about *this* being an absolute), that there is no right or wrong (but they are sure *this* is right), that there is no certainty in life (but they are *certain* of this), that life is a pathetic farce (on this count, they are partially right, but only as it applies to their own lives), that we are all victims of our surroundings (let them speak for themselves), and that the government is the solution to all of our problems.

In case you think I am exaggerating, let me tell you that all of these things were being routinely taught by professors in the '60s. I was there and I know. And they are teaching the same things and worse, today.

I can recall, nearly 30 years ago, telling my Dad about what was being taught in college. He was skeptical, thought I was perhaps guilty of youthful exaggeration, and found it hard to believe that anyone would teach such things. In any event, he didn't think anybody would believe such things, so he thought the teachings of my professors would be of no practical consequence. This mistaken perception underscores the insidiousness of this destructive process.

Scores Decline as Values Are Eroded

Let's go back now to the declining test scores of our youngsters, scores which have been declining for more than two decades. Do you begin to see the connection between those scores and the anti-heroic, anti-certainty, anti-right-and-wrong culture of the last 30 years? What is the point of struggling to learn to read, to master mathematics, or to write, if there are no absolute values worth preserving?

You will not see reports on the evening news about the staggering casualties at the hands of our cultural and educational institutions (the fact that you don't is a disgrace). The exception is an occasional story about the number of students who *graduate*(!)

from high school but cannot read or solve simple mathematical problems. The widespread waste of our young minds casts a dark shadow on the future of our country.

When you see destruction on such a wide scale—the declining test scores, the rising use of drugs, the decline of self-reliance and honesty as virtues—there can be only one cause: the ideas which are being spread by our cultural institutions and, most especially, by the teachers in our universities.

America's Brain Drain

One normally associates the term brain drain with the situation that has occurred in countries with centrally planned economies: the best minds flee the country. This disappearance of engineers, doctors, scientists, and professionals of every sort devastates that country's economy.

However, America's brain drain is and will be different: the best minds will not, for the most part, leave the country, *they simply will never develop*. In increasing numbers, young men and women will simply give up the quest to develop their minds to the fullest. After all, they have been taught all of their lives that it is foolish to carry on the struggle of the hero, to attempt to do what's right (right?—a foolish concept of the ignorant and uneducated, according to the teachers) and achieve great things (great?—nothing is great and if it were, no one could define it).

There is, however, an element of America's brain drain which will be and is now similar to what has occurred in socialist countries: professionals of every sort are retiring at an abnormally early age. This early retirement isn't the result of the well publicized downsizing of America's corporations. This is the result of people quitting their professions out of disgust and weariness. Most of the evidence for this phenomenon is largely anecdotal, but it is happening at an accelerating pace.

Doctors are retiring from medicine at an early age because encroaching government policies and our runaway legal system are threatening their very existence. Small busi-

ness owners are shutting their doors because they are tired of the hassle of government regulations, which make their businesses increasingly unprofitable, and out of fear of lawsuits. If you think long enough, you can probably think of someone you know who has quit his profession because of disgust with government intervention, bad employees, or the increasingly hostile legal environment.

There are countless other professionals, in all walks of life, who would retire today if they could afford to do so. Virtually everyone, including you, knows someone who falls within this category.

And then there are the potential businesses which will never be started. To start a business requires guts, heroism, dedication, vision, and *political freedom*—the very things which our cultural institutions have sought to destroy.

The president of a company in Indiana recently told me a haunting story of a young man who was one of the brightest and most talented individuals in his industry. The young man had considered starting his own company, but finally decided it wasn't worth it: too many problems with government regulations, lawsuits, and employees. If this young man had started out back in the '50s, he probably would today be the owner of a business employing dozens of people. But not today.

Hope for the Future

There is still hope for the future of this country, but only if we seize upon a dramatically new approach to education, one which will reverse the destructive trends which have been produced by an entrenched bureaucracy of educators who are dependent upon government funds for their livelihood and who have a vested interest in promoting the government as the solution to all of our problems.

The quickest way to begin the reversal of the current brain drain is to *eliminate* any and all government involvement in education. This is, I know, going to strike most as radical, and it is.

Consider the following. The decline in our students' test scores roughly coincides with the rise of government spending on education, most especially on the federal level. The more the government spends, the worse the results. Throwing more money into this bottomless pit is futile. Apart from the fact that it is morally wrong for a government to use force to take your money to pay for education, state-run schools, with few exceptions, have done an atrocious job of educating our young.

However, the most important issue here is one of individual rights and property rights. Remember, the government is an instrument of force. It can either be the protector of rights, property, and liberty, or it can be the greatest threat to these things. Today, the government is the greatest threat to our freedom, and our individual property rights. What does this have to do with education? More than most realize.

If your neighbor came to your front door with a gun in his hand, demanding money to pay for his kids' education, you would consider this wrong. It is nothing more than theft, notwithstanding the worthiness of his cause. However, if that same neighbor, rather than robbing you directly, goes to the voting booth and votes for a property tax, which will force you to give up money to fund public schools, you might not like it but you probably wouldn't consider it robbery. However, the truth of the matter is that your neighbor is using the government's power to take your money, and it is as if he had robbed you at gunpoint. The only difference is that he's getting the government to do it for him. This isn't right and no one can justify the use of government force in this manner. Such action is a violation of individual rights and of your property rights.

In a free society, you would be free to pay for your own children's education (or someone else's, if you so desired) or contribute to the institution of your choice. Each student attending school would do so by choice and would *want* to be there because he *wanted* to learn. Today, you are *forced* to pay for programs, courses, and teachers imparting ideas you would not voluntarily support.

Freed of the burden of paying taxes for education, you would have the funds to pay for private education. And, contrary to popular belief, private education would be comparatively inexpensive and affordable. Competition would make education affordable and widely available.

The quality of education, with the elimination of public schools, would rise dramatically. These schools and their teachers would have to compete for your business. There would be a strong incentive for the schools to provide the very best results for your children *and to teach the best ideas*. The schools and teachers would be responsive to your concerns because you would be free to go elsewhere if you were displeased. Today, few parents have that choice because few can afford to pay the taxes for public education and also pay to send their children to private schools.

Dismantling publicly funded educational institutions will not, by itself, eliminate the forces which have created America's brain drain; but privatizing education will establish the precondition for destroying these forces.

Today, our public educational institutions are heavily dominated by teachers who are committed to a philosophy of anti-certainty, anti-right-and-wrong, and anti-freedom. In a free market system of private education, few parents (and few students) would pay for courses which teach such a philosophy if they were spending their own hard-earned money. They would seek out those teachers who have something better to offer, thereby creating an opportunity for teachers who have something better to offer. Today, those teachers who disagree with the academic establishment are virtually shut out of our educational process.

A free market system of private schools will bring out the best ideas from our teachers and bring out the best in our students, thereby creating the beginnings of the reversal of America's brain drain and opening the road for an intellectual and economic renaissance in America. That shining vision of America, the vision projected by the Founding Fathers, will, once again, have a chance to be seen by our young, and light the way to a bright future for us all. □

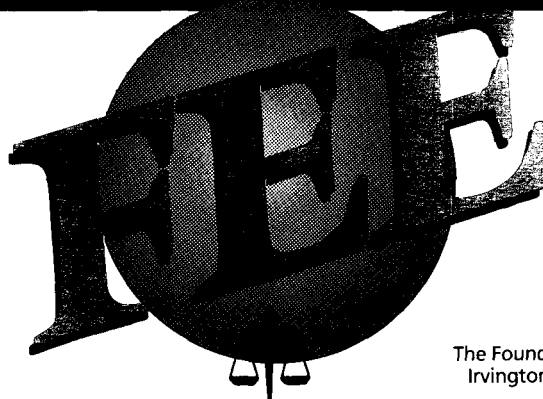
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UNDERGROUND GOVERNMENT

When the burdens of government become oppressive, many individuals are tempted to escape their obligations, even in violation of legislation and regulation. They may become tax dodgers, work without a license or hire unlicensed labor, work off-the-books, or enter black markets. They may escape to the wide world of underground activity.

In a similar way, politicians, legislators, regulators, and other agents of officialdom seek to escape all efforts toward curbing them. When threatened by budget cuts, they may react by going "off budget." Whether they are committed philosophically to the growth of government or merely to defending and enhancing their jobs and economic existence, they may react by going off-the-books.

Public officials may establish public corporations in any line of business from housing and transportation to the construction and management of airports, libraries, theaters, stadiums, zoos, and other forms of "public enterprise." These are off-budget enterprises (OBEs), launched lavishly and wastefully, paying no taxes when in operation, suffering staggering losses which are placed on the shoulders of taxpayers, but paying generous wages and salaries with multitudinous fringe benefits for little or no effort. Their spending and borrowing are deleted from any government budget or record, their debt is exempt from any constitutional debt limitation, nor is it subject to any voter approval. Government activity thus is made to disappear from public view and inspection by creating a public corpora-

tion with a simple stroke of a pen

Off-budget enterprises operate outside the government structure. They are not "taxing districts" which are endowed with taxing power and managed by elected officials. OBEs lack taxing power but enjoy vast spending power. They are managed by appointed directors who are either self-appointed government officials or their relatives and friends. In some cases the appointees are selected along party lines according to party loyalty.

An OBE is a non-profit business exempt from many onerous regulations; it may compete with private enterprise which is hampered and taxed by the very authorities creating the OBE; or it is protected from business as an unregulated monopoly. It may be the only licensed ambulance service in the community, charging monopolistic rates that may even exceed those of the community hospital. As the only licensed airport management company, it is likely to charge monopolistic rates for hangar rentals and repair services. As the only licensed incinerator service in town, it is likely to charge monopolistic rates for garbage incineration. Despite their monopolistic position created by licensing officials, OBEs generally suffer large losses because of poor management, poor labor, and poor customer service. The OBE losses inevitably create mountains of debt which usually are assumed or guaranteed by the political authority that created the OBE. When the losses become politically embarrassing the parent authority may have to liquidate the enterprise or sell it to private

buyers who are willing to assume the debt. There are always some buyers waiting in line for political favors, especially for the opportunity to acquire a license monopoly.

There may be some fifty thousand OBEs in the United States issuing tax-exempt bonds not subject to any taxpayer vote or legal restriction. They are giving employment to countless political favorites and dispensing economic favors to their friends in exchange for political support. Their number seems to be directly proportional to taxpayer efforts to impose tax and expenditure limitations. When tax revenues decline, officials on all levels begin to evade rather than accommodate. When local officials go underground, federal officials can be expected to encourage the move by providing grants-in-aid or extending loans directly to OBEs. Aid may be extended by an off-budget federal enterprise to an off-budget state or municipal enterprise with a few politicians and officials deciding the issue. Taxpayers have no voice in such matters.

OBEs masquerade under various guises such as boards, authorities, agencies, commissions, corporations, and trusts. In Pennsylvania, this writer recently counted 2,548 municipal enterprises pursuing 2,896 projects most of which are off-budget. There were 37 airport authorities, 121 parking authorities, 691 sewer authorities, 298 water authorities, 97 recreation authorities, 48 solid-waste authorities, 82 health authorities, 95 other single-purpose authorities, and 341 multi-purpose authorities. They were borrowing half a billion dollars a year and carrying a debt of \$8.2 billion. Throughout the United States, an indeterminable number of municipal authorities owe an estimated long-term debt of more than half a trillion dollars of which one half may consist of "full-faith-and-credit" issues and the other half of nonguaranteed "moral obligation" issues.

On the state level, hundreds of OBEs spend undisclosed sums, borrow as much as the states themselves, and carry a long-term "moral obligation" debt that may approach a trillion dollars. The state of New York seems to lead the way with an OBE debt at times amounting to four times the guaranteed voter-approved debt. Throughout the 1960s and 1970s, it provided the way of escape from taxpayer opposition and restraint.

When voters rejected a \$100 million housing bond issue *for the third time* the New York legislature created the Housing Finance Authority which promptly issued nonguaranteed debt obligations exceeding the total full-faith-and-credit debt of New York State. When New York voters rejected a higher-education bond issue *for the fourth time*, the legislature created the off-budget State University Construction Fund. When voters rejected a public-housing bond issue *for the fifth time*, the state legislature created the Urban Development Corporation. When UDC defaulted on its massive obligations the legislature in Albany created yet another OBE, the Project Finance Agency, which issued more OBE bonds to pay the bills of bankrupt UDC and cover the deficits of other OBEs. Obviously, politicians and officials have moved much of their activity beyond the direct control of taxpayers.

On the federal level, politicians and officials wax eloquent about the need for deficit reduction but continue to spend as if there is no tomorrow. Simultaneously, they have built several avenues for going off-budget. They may simply remove certain federal activities from the U.S. Budget or create new off-budget entities to carry out federal programs. They may conduct policies through privately-owned but government-sponsored-and-controlled enterprises (GSEs). And they may conduct numerous government loan-guarantee programs which channel private credit toward federally selected programs. All these avenues of escape make government activity appear much smaller than it actually is. (Cf. Hans F. Sennholz, *Debts and Deficits*, available through FEE).

No constitutional amendment, law, or regulation can impose integrity and frugality on politicians and officials with the backdoors left wide open, giving rise to countless off-budget agencies and public enterprises. The possibilities for concealment, deception, pretext, sophistry, stratagem, and plain trickery are endless.



Hans F. Sennholz

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Every first Saturday of the month, beginning in March, several well-known individuals will lead the discussion of a vital issue of the day. Each round-table meeting will be preceded by a reception and dinner beginning at 5 p.m. Charge: \$30.00. Attendance limited to 50 persons.

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Drs. Hans Sennholz, John Robbins, and Doug Bandow will open a discussion of "federal stimuli and pump priming." Special emphasis will be placed on practices and policies.

April 3 Round-Table

Drs. Hans Sennholz, Ron Paul, and Llewellyn Rockwell will open a discussion of "rituals of tax reform" and recent changes in federal law.

May 1 Round-Table

Drs. Hans Sennholz, John A. Sparks, and Clarence Carson will discuss "illiberal education" in its many facets and forms.

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Every third weekend of the month beginning in March, a well-known scholar and writer will hold a seminar in his field of expertise. The seminar will begin on Friday with a reception at 5:00 p.m., followed by dinner and a lecture. Sessions will continue on Saturday, concluding with a dinner in the evening.

Tuition, two nights' lodging, and food, including Sunday breakfast — \$260.00. Attendance limited to 40 persons.

March 19-21 Seminar

Robert J. Bidinotto, *Reader's Digest* Staff Writer and author of *Crime and Consequences*, will examine and sit in judgment of the criminal justice system.

April 16-18 Seminar

Dr. Gary North, President of the Institute for Christian Economics, brilliant author of a dozen incisive books, and frequent contributor to *The Freeman*, will speak on the political gospel and liberation theology.

CLASS EXCLUSION NOTICE

The Airlines Antitrust Litigation

P. O. Box 275

Mt. Royal, NJ 08061-0275

Dear Sirs:

My wife (Lois) and I (Virgil) recently received notices (copies attached) indicating that we are members of the Class.

From reading the notices, we see that we qualify to file via AIRLINES ANTITRUST LONG CLAIM FORM C.

1. During the period January 1, 1988 to June 30, 1992, Lois and I have bought airline tickets and flown. In addition, we have bought tickets for our two sons so they could make various flights. And we have also bought tickets for my dad so he could make various flights. We have purchased tickets in all of those years.

2. Most of our flying has been on one of the airlines listed, namely, Delta. We have probably flown on one or more others, but I haven't checked to verify for sure.

3. We have flown in and out of several of the airports listed in the notices.

4. Attached are copies of recent VISA card charges that illustrate that we qualify.

Lois and I are writing to *request exclusion* from the Class.

We hope that we are two of a sufficiently substantial number who want to be excluded from the Class so that this whole sordid undertaking gets terminated.

I quote from the notice, Section I, BACKGROUND OF THE LITIGATION:

The lawsuit charges that during the period

January 1, 1988 to June 30, 1992, the airline defendants and ATPCO violated the antitrust laws by engaging in an unlawful conspiracy to fix prices for domestic air transportation and to allocate certain airline markets and airports and that, as a result, prices for airline tickets for such flights were higher than they otherwise would have been.

That foundation for the lawsuit is so ridiculous that any judge worth his salt should throw the suit out immediately. Let us just give you some examples that come to mind.

1. First and foremost, it is obvious to the most casual observer that concern for those of us who paid airline ticket prices "that were higher than they otherwise would have been" has nothing whatsoever to do with the real motivation for the suit.

Anybody who knows the slightest thing about what is going on can tell that the plaintiffs' lawyers see an opportunity to make a fortune by attacking a group of businesses that the lawyers perceive as having deep pockets.

If the lawyers really had so much concern for how much we travelers pay in airline tickets, they would have started one or more airlines of their own and charged us less.

What the lawyers for the Class are trying to do is get some kind of government-

approved theft, all in the name of the Class. Then the lawyers will pocket huge amounts of money for themselves.

This kind of legal harassment will drive airline prices up a whole lot more than the supposed price-fixing conspiracy claimed in the lawsuit.

2. Secondly, there may be antitrust laws on this subject, but if I were on the jury trying this case, I would vote to invalidate those laws.

If a person knows anything about economics and business, he knows that the only kind of monopoly that can be created and sustained is one created and sustained by government power. Thus, if the airlines are truly deregulated, like they should be and supposedly are, no one airline nor even all of them working together could create and sustain a monopoly.

For heaven's sake, inflation-adjusted airfares have been less since deregulation than previously when the federal government conspired to fix prices, routes, airport slots, and the whole rest of it. Anyone watching this year's airfare wars knows that it's a tough, *competitive* business. So much so that the airlines are lowering fares to the point of being non-profitable.

Not even the multi-governmental Organization of Petroleum Exporting Countries [OPEC] can keep its cartel working the way the wrongheaded antitrust theorists proclaim; gas prices are lower now than they were years ago. That's due to worldwide competition, not antitrust laws. The anti-trust laws should be thrown out along with this lawsuit.

3. Thirdly, all of us that bought airline tickets did so freely. No airline used any kind of force, intimidation, extortion, threats, or anything else of that type to make us buy their tickets or fly on their airline. We did it

voluntarily. We *must* have gotten a good value, or else we wouldn't have done it.

You know, we could have driven our cars, or taken a bus or train, or even stayed home.

So, even if the airlines did work together to fix prices, routes, airports, etc., that is totally irrelevant. We bought their product voluntarily; and we're glad we did.

And that is more than can be said for this Class action lawsuit. The lawyers for the Class caused us to be included involuntarily—we want out of the Class. Furthermore, they are forcing taxpayers to fund their crazy game; it costs money to run the governmental side of this type of undertaking. And then airlines (and lots of other businesses, too) have to increase their prices in order to have money to fend off this type of harassment.

4. We say the lawyers for the Class are the guilty ones. The case should be dismissed. The lawyers for the Class should not be awarded even \$1.00! They should be severely reprimanded and told to never start this type of suit again.

Let us say it one more time. If the lawyers who have hatched up this attempt at governmentally approved theft were so concerned about the airline ticket prices we travelers pay, those lawyers would start and run one or more airlines and set their prices lower than their competition. The fact that they haven't even attempted to do that is conclusive proof that they are not really interested in the price we pay for plane tickets.

Sincerely,
Virgil L. Swearingen
Lois A. Swearingen

Mr. and Mrs. Swearingen, who describe themselves as "ordinary citizens who fly on airplanes," reside in Fresno, California.

SCHOLARSHIP, LEADERSHIP, AND PUBLIC WORKS JOBS

by William R. Allen and William Dickneider

Universities have a special mission. Not only do they teach the accumulated lore and wisdom of the tribe, but they also push out the boundaries of knowledge. Teaching and learning old truth, much less discovering additional truth, require uncommon characteristics. Students and professors are to be insightful, honest, and dispassionate—hardheadedly adhering to the highest standards of logic and evidence.

Alas, there is much dribbling between the cup of ideal and the lip of reality. There are of course, scholars who struggle effectively and fruitfully with important problems and issues. But the campus is infested with soft and silly charlatans who rely, not on disciplined sense, but on emotional sensibility, on persuasion only through rhetoric, on pressure of ideology, on charisma rather than comprehension.

A campus newspaper essay illustrates the point. Written by a graduate student of history, the article discerns (as all campus newspaper essays do) grievous problems—poverty, drugs, unwanted pregnancies, mental disease, homelessness. After listing the problems, the essay makes no attempt to

explain their causes. Nor does it try to use knowledge of how the world works to suggest even limited strategies of marginal improvement. Rather, it only pleads for comfort, general reassurance that (in ways admittedly mysterious) a government leader will resolve our pains and frustrations.

But where are these reassuring leaders? We are political orphans. “I would give anything,” the author cries, “to hear” Franklin Roosevelt and Lyndon Johnson “once again calling the nation to arms in a war against poverty.”

Whining for leadership from someone in the White House or on a white horse will not give us prosperity or freedom. Nor will it give us more jobs. Yet, with employment slumping, politicians, like university poseurs, would have us believe in a simple solution. With vast public works projects to build and rebuild so-called infrastructure—roads, bridges, sewers—we could increase jobs.

Maybe we have neglected our infrastructure. Perhaps we would be more productive if we invested more in maintaining and expanding such basic capital. But the condition of our infrastructure commonly is not the central issue. The more immediate question is whether government spending would increase total employment.

Public works programs clearly would di-

William R. Allen is professor of economics at UCLA; he and William Dickneider collaborate on the Midnight Economist radio program, syndicated by the Reason Foundation of Los Angeles.

rectly create specific jobs. But expansion of public works jobs is likely to cause jobs to contract elsewhere, with little net change in employment. Other employment will contract because federal expenditures on public service jobs must somehow be financed. If the federal government is to increase spending for public works, then it must reduce other government expenditures, raise taxes, or deficit-spend.

If government reduces spending for other programs, such as national defense, then fewer workers will produce guns. Or if government reduces transfer payments to individuals, then fewer workers will produce the butter that beneficiaries would have demanded. In either case, decreases in federal expenditures in one area to make room for increases in public works will not increase total employment.

Instead of curtailing some of its other spending to increase expenditures on public works, government might curtail private consumption and investment by raising taxes. With private spending down and government spending up, public jobs are traded for private jobs, but total employment is not increased.

If, alternatively, government finances the expansion of public works by enlarging its already-swollen deficit, then it will either have to borrow existing money or create new money to pay its increased bills. If it is to borrow existing money from the community, government would compete more intensely with businesses and households for scarce credit. More credit would then go to government and less to private firms and individuals. Government spending of borrowed funds would displace private spending of private funds. Again, some jobs are traded for others.

Finally, what if government financed its increased deficit spending by creating new money? In this instance, spending would not fall in other areas, so new public works jobs would not reduce other employment—initially. But down the line, increased

money creation, if continued fast enough long enough, will raise prices. And higher prices—which are a form of taxation—would threaten future productivity and employment. We would then obtain a bit more force-fed employment today at the expense of less employment and more misery tomorrow.

No matter how government finances it, greater spending for public works jobs is not likely to increase the total number of jobs. Economic thinking leads to this conclusion, but does history support it?

Our economy is not a laboratory in which experimentation easily yields conclusive evidence. But we can look at how government spending in general has related to total employment.

From 1960 to 1992, bigger increases in federal spending were *not* typically associated with larger increases in payroll employment. Indeed, the loose relationship that existed over those three decades is quite the opposite. Faster growth of employment has been associated with slower growth of federal spending; and slower growth (or reduction) of employment was more likely when federal spending grew faster.

In 1975, government spending exploded by more than 23 percent, and employment change was actually negative; in 1980, spending shot up by over 17 percent, and employment was virtually constant. To take longer illustrative periods, from 1962 to 1966, spending rose at a below-average annual rate of 6.7 percent, and employment expanded robustly at 3.4 percent. In contrast, from 1975 to 1981, spending surged at 14.2 percent per year, and employment rose at only 2.2 percent.

Like poverty, homelessness, and other complex problems, today's sluggish employment growth has no easy solution. We can do better than we have done in sustaining a vigorous economy. But it should be apparent, even to the denizens of academia, that government cannot simply and surely spend us to rapidly expanding employment. □

THE FORGOTTEN CONSUMER

by Eric-Charles Banfield

Frequently both sides in an argument are wrong. When looking at free trade and free-market issues, both opponents and proponents invariably focus only on the producer side—how many jobs will directly be created or lost—and both sides completely ignore the effect on the consumer and his role in economic growth. With a poor understanding of the market process, both sides make false arguments.

Last year former U.S. trade representative Carla Hills debated Senator Don Riegle about the potential effects on jobs of the North American Free Trade Agreement (NAFTA). In committee testimony and on business news shows, Senator Riegle said Americans in several industries would lose jobs to Mexico (and Canada), and that only bankers and other financial-sector employees would gain. Ms. Hills countered that U.S. firms in many sectors would be able to sell more goods and services in Mexico and Canada, and that means more jobs for Americans.

Framed that way, the issue seemed one of netting out the “gainers” and “losers,” all in terms of “how many jobs.” The debate degenerated into a “sector analysis,” with Hills and Riegle sounding like stockbrokers arguing over which industries to invest in. Worse, Hills fell into Riegle’s trap: Neither

debater ever used the word “consumer,” the real reason for free trade.

The misguided “jobs” focus hits close to home, too. Wal-Mart founder Sam Walton’s death led many to eulogize his great business achievements. But many in small U.S. towns and even some urban areas reacted critically, saying the emergence of Wal-Mart stores, with their low prices and good selections, drove their local but expensive mom-and-pop stores to ruin. The issue to them was “jobs.” Again, no one mentioned the consumer.

In both cases, debaters (and the media airing their views) made the same mistake: looking at free trade and free markets as primarily a jobs issue, and completely ignoring the consumer issue: That trade means competition and lower prices for consumers, and that helps economies. In economic terms, they focused on the possible loss in “producer surplus” and ignored the certain gain in “consumer surplus.”

If Not for Jobs, Then Why Free Trade?

Freer trade creates tremendous economic benefits. A bottom-up process, it diffuses its effects across all markets and at all stages of production. Lower tariffs and increased competition reduce prices to consumers, enabling more people to enjoy the benefits of goods and services at prices lower than they

Eric-Charles Banfield is owner of Banfield Analytical Services in Westmont, Ill.

were willing to pay before, and in greater quantity. That increased consumer surplus means either:

(1) more money available in people's budgets to buy an additional quantity of goods and services, adding to demand and growth; or

(2) more money to save, adding to investment and capital formation; or

(3) higher-quality goods at the same price and in the same quantity.

Those direct, primary benefits, valuable in their own right, should be sufficient to make the case for free trade, regardless of jobs.

If jobs are still at issue, then the free-trade case is yet stronger. Those three consumer benefits mean:

(1) greater demand for goods and services from producers and suppliers, which creates jobs;

(2) more credit and capital for new ventures, which creates jobs; and

(3) a higher standard of living, which certainly can't hurt jobs.

Yet both opponents and proponents obscure the solid demand-side case for free trade by emphasizing employment, a secondary consideration.

Creative Destruction

In the perpetual motion of economic change, jobs are constantly destroyed and created. A freer level of trade, especially if brought about suddenly, will no doubt destroy some jobs in some sectors, but will create jobs in probably every sector of the economy.

Politically, that's the trap. As Frederic Bastiat said in 1848, "there's what you see and what you don't see." Observers will be able to see fairly clearly which jobs are destroyed by competition from cheaper suppliers. They'll find it much harder to identify, on the other hand, which jobs have been created by the diffuse benefits that accrue to consumers.

An auto or textile plant can lay off workers, and cameras can capture that on the evening news. But who will notice that increased consumer demand and capital availability will cause thousands of small businesses to start? Politicians won't be able to point to a new job and say "free trade created that job," but they can point to a layoff at a textile plant and say "free trade destroyed that job." That's why "jobilism" is such a common campaign tactic.

Try Some Real Populism

But if people want to use populism to bolster their case for or against free trade, why appeal to employment? Better to appeal to consumers: Everyone is a consumer. Everyone will save money from lower tariffs and increased competition. What could be more "popular" than that?

But even alleged supporters of free markets fail to make the proper appeal to consumers, letting the opponents set the parameters for the discussion. That could cost them the debate. Unfortunately, if they fail to make the proper case for free trade, it is consumers who will face the greatest cost, quite literally. □

The Function of Protectionism

THE main function of tariffs and other protectionist devices today is to disguise the real effects of interventionist policies designed to raise the standard of living of the masses. Economic nationalism is the necessary complement of these popular policies which pretend to improve the wage earners' material well-being while they are in fact impairing it.

—LUDWIG VON MISES, *Human Action*

IDEAS
ON
LIBERTY



THE CASE FOR SHOPPING AT KROGER

by Anthony Woodlief

The Kroger grocery workers in my section of Michigan recently ended a strike of several weeks after management gave in to some of their demands for higher wages and benefits. Most of my friends and acquaintances refused to shop at Kroger while the employees were on strike and were shocked that I did not join their boycott. When they visited me, some even asked for assurances that the food I was serving had not been purchased from Kroger. The University of Michigan graduate student teaching union, to which I am forced to pay dues, organized members to help the Kroger workers picket and harass customers. Union officials and opinion columnists assailed us non-boycotters in print with arguments about how Kroger was denying its employees “justice” and “fair” or “decent” wages. To them we were just “classists” who don’t care about the American worker.

One does not have to be a bleeding heart liberal to be concerned about the condition of low-wage workers, however, any more than one has to be a Social Darwinist to reject the arguments of the strikers and their sympathizers. Not only was it possible for those of us who cared about the conditions of low-wage workers not to support a boycott of Kroger while its workers were on

strike, it was in fact the best way to show we care. Here’s why:

Economic theory suggests that wages, like other prices in a competitive market, reflect the value of their product to others. If prunes suddenly were to become the nation’s favorite fruit, we would see this increased value reflected in rising prune prices. If Michael Jordan’s vertical leap were to drop to three inches, we would see the decline in his value as a basketball player reflected in his salary. Likewise, grocery workers, who are clearly in a competitive market in this area, can see the value of their labor to the rest of us reflected in their wages. Grocery workers were probably earning what stocking shelves, punching keys on cash registers, and labeling food is worth in a modern economy, where food production and distribution is hampered by regulations and taxes, yet is still efficient, cheap, and competitive.

If Kroger workers were in fact being underpaid in a market sense, they should not have needed a boycott by customers for their strike to be successful—Kroger should have been unable to find enough useful workers at the prevailing wage. Indeed, Kroger was able to find replacements at lower wages, but the accompanying boycott forced them to reconcile with the union. Many people sympathetic to unions, however, do not think in terms of the value of the

Anthony Woodlief is a third-year graduate student in American government at the University of Michigan.

product of a worker's labor. They seem to think in terms of the value of the worker as a person. Hence the union did not argue that Kroger should pay its employees a fair price for their labor; it demanded a "decent wage," defined only as being higher in terms of salary and benefits than current wages. Certainly, if they accept the Marx-influenced notion that wages are a reflection of a person's intrinsic value, their visceral reaction against low-wage jobs might be justified. But if that is their belief, they should be open about it and work for the destruction of what is left of our free market in the United States. In its place they could appoint a group of experts, presumably union officials and college professors, to dictate what each of us is worth as humans.

Fortunately, outside a few tenured radicals and disillusioned members of the Revolutionary Workers League, strike supporters would not favor abandoning a market economy. Instead, they would like to modify it and make it more humane, by their standards. With regard to the Kroger workers, most sympathizers don't think in Marxist terms (although their thinking is influenced by these terms more than many of them know); they simply believe that honest workers deserve a decent standard of living for themselves and their families. If this is the goal, however, then working toward it by boycotting Kroger seems misguided for two reasons.

Forcing Kroger to provide salaries and benefits higher than mandated by the market will have at least three results: fewer employees, lower profits, and eventually higher prices for consumers. To understand the first point, remember that when we cut larger pieces of the pie, fewer people get a piece. We don't have to rely on pastry theory to get these results; American economic history reveals that mandatory wage increases produce higher unemployment and inflated prices. It is no coincidence that heavily unionized states, like Michigan, also have a higher than average cost of living. A successful boycott by union sympathizers means higher wages and benefits for some at the expense of future potential employees

who will be turned away. Furthermore, if Kroger's profit margin is already very slim, a successful boycott could mean that all the employees lose their jobs if the company decides to pull out of the area.

On the other hand, if Kroger's profits are large, they will shrink because of the higher costs. These shrinking profits will signal investors to place their savings elsewhere—leading, in the long run, to fewer jobs in the grocery business.

When I argue to my liberal friends that a successful strike will mean higher prices, the response is always the same: "So? Unlike you, an uncaring fascist, I don't mind paying a few extra dollars for my groceries each week if it means that those people will be paid a living wage!" This raises my second point. The fact that wages, like other prices, send signals from buyers is only half the story. Not only do they reflect market value, they send signals to producers. In the earlier example, a sudden national craving for prunes would not only yield higher prices, it would stimulate investment in prune production as entrepreneurs tried to get in on the profits. Similarly, higher wages for a job, all other things equal, will attract more people to that job. If we force Kroger to pay wages on which a high school dropout can support a family, we in effect make it easier to be a high school dropout. Wages, in other words, are signals about what consumers value, and artificially inflating the wages and benefits of grocery workers tells other workers and potential workers that this is a profession they should choose.

The belief that everyone deserves a certain living standard does not necessitate support of demands by low-wage, unskilled workers for higher wages and benefits. Requiring government to meet those demands with income transfers would be a less dishonest way to address the costs of these dubious goals and would avoid some of the market distortions created by paying artificially high wages for a job that is not worth that much to consumers.

Of course, the American public is probably much more sympathetic toward demands for a "decent" wage, with its hidden

costs in terms of prices and efficiency, than they would be toward an outright welfare program for workers whose skills are not very valuable to the economy. That certainly explains why we have protectionist automobile policies that cost consumers more in higher prices than if we simply paid each auto worker laid off because of foreign competition a \$50,000 salary. But perhaps that is the reason why unions and their supporters speak in terms of wage "decency" rather than living standard entitlement—it allows them to obfuscate the issue and avoid difficult questions about the origin of their "entitlements" to our income.

Friedrich Hayek stressed that in a free market economy, some people necessarily fail through no fault of their own, because no one can foresee future preferences. Whether this applies to poorly educated

Kroger workers is unclear (although the case can be made that the public education system has failed at least some of them). What is clear is that if we want to help people obtain our idea of a decent living standard, we should not go about doing so by distorting market signals and telling other unskilled workers and potential workers that society values their shelf-stocking abilities enough to support them and their families with high wages. If we are truly interested in thoughtful solutions to the problems of unskilled workers, we should make the costs of being unskilled clear, and work toward revamping our education system and eliminating roadblocks in our economy so that these people have more options. But perhaps for some people, like a few of my colleagues, being politically correct is more important than thoughtful solutions. ☐

New from Economics America!

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RICHARD COBDEN: CREATOR OF THE FREE MARKET

by John Chodes

The first half of the nineteenth century in England was much like contemporary America: It was a country strangled by bureaucratic regulations. Many people were always hungry, not because of poverty level wages, but because the price of grain for bread was kept artificially high by laws which simultaneously prevented the importation of foreign grain and subsidized domestic producers. Food riots, domestic unrest, and a stagnating economy were not sufficiently frightening to make the government eliminate these barriers.

In the midst of all this lived a successful young Manchester textile manufacturer named Richard Cobden. He saw the social injustice, and it made him furious. He was determined to change it, and he did. As a result, the world owes the existence of the free market to him. Cobden demonstrated methods that we can use to break down our own protectionist “fair trade” laws and massive food subsidies.

Richard Cobden began his public life by leaving his calico printing company to his brother. He received a portion of the profits, which allowed Cobden to devote full time to the cause of free trade. It seemed an impos-

sible task. Yet, seven years later, England had undergone a revolutionary economic, political, and social change. Taxes on grain had been decimated. Unequaled prosperity flooded England. For the next 85 years Britain maintained world economic leadership, and the rallying cry of “free trade” became much more than an economic slogan. Free trade denoted the philosophy of limited government, social justice, and freedom.

Cobden understood the moral truths behind unregulated commerce. Breaking down barriers to trading freedom broke down class barriers and obstacles to civil rights. It reduced military expansion, since a powerful navy was a legacy from the old mercantile idea that warships protected trade between colonies and other controlled markets.

The Corn Laws

Protectionist tariffs were called “Corn Laws.” They restricted the free flow of corn, wheat, barley, and oats between Great Britain and foreign countries to shield the British farmer from competition.

Systematic government interference in grain production began in the 1660s. The amended Corn Law of 1774, which controlled legislation for the next half century,

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is a typical example: when the domestic price of corn, as paid to the farmer by the baker or dealer, fell below £2.4 a quarter (28 pounds), the farmer was encouraged to sell his products abroad, to prevent the market price from falling still further. He was given a bounty of five shillings for each "quarter" exported. When corn sold for £2.8, export was forbidden. At prices between these levels, there was a duty of six pence a quarter. Over time, this system became progressively more bureaucratized, with elaborate regulations specifying how and in what town the price was to be measured, with specific procedures for reporting and allowances for regional differences.¹

The Corn Laws displayed another characteristic of government controls: Regulations and subsidies in one area led to the manipulation of tangential areas. In this case, when bad harvests triggered soaring grain and bread prices, the Corn Law mechanism exacerbated the problem, causing still higher prices. This provoked civil disturbances to the point where the government feared insurrection. To defuse the threat, workers' wages were subsidized, relative to the price of bread. This subsidy came from the "Poor Rates," the British nineteenth-century welfare system. This greatly expanded state entitlement programs, leading to massive fraud, inequities, and even greater civil unrest.

The Corn Laws are not merely things of the past. Their spirit exists in most countries of the world. In the U.S. today, agricultural products are subsidized and stored, to the tune of tens of billions of dollars annually, to keep the price of food artificially high. This enhances the farmer's income but it also prevents the poor from eating as they should. This has led, as in nineteenth-century England, to protectionism, international tensions, and the threat of trade wars.

Richard Cobden: Businessman to Pamphleteer

Cobden was born in Dunford, West Sussex, in 1804. Because of a succession of family business failures, his father could not

support young Richard. He went to live with an uncle who trained him to be a clerk in his London warehouse. At twenty-one Cobden became a traveling salesman. He was so successful that in 1831 he went out on his own and took over the calico printing company in Manchester.

Manchester was the world's first great industrial city. It was viewed as the metropolis of the future. Alexis de Tocqueville best explained the paradox of Manchester: "From this foul drain the greatest stream of human industry flows out to fertilize the whole world. From this filthy sewer pure gold flows. Here humanity attains its most complete development and its most brutish; here civilization works its miracles, and civilized man is turned back almost into a savage."²

In Manchester Cobden had his first lesson as to what free trade meant. As he assumed ownership of the company, the protective tariff on calicos was repealed, making it possible to export them competitively. This opened up vast new markets that could not exist before, allowing Cobden to develop a new kind of international selling strategy. Cobden "introduced a new mode of business. The custom of the calico trade at that period was to print a few designs, and watch cautiously and carefully those which were most acceptable to the public, when larger quantities of those which seemed to be preferred would be printed off and offered to the retail dealer . . . Cobden and his partners did not follow the cautious and slow policy of their predecessors, but fixing themselves upon the best designs, they had those printed off at once and pushed the sale energetically throughout the country. Those pieces which failed to take in the home market were at once shipped to other countries and the consequence was that the associated firms became very prosperous."³

Yet, at the height of his achievements, Cobden's interest in calico waned. He was eager to pursue other courses. By 1835 he wrote his first political pamphlets. One, called "Russia" (describing the threat of Russia against the decaying Turkish Empire), contained the core of this mature

thought: "It is labor improvements and discoveries that confer the greatest strength upon a people. By these alone and not by the sword of the conqueror, can nations in modern and all future times hope to rise to power and grandeur."⁴

Cobden wrote that England's rulers inhibited discovery and improvements by wasting millions on the military. His favorite target was Britain's obsession with the doctrine of the balance of power. He saw it as a source of conflict, not stability. "Empires have arisen unbidden by us; others have departed despite our utmost efforts to preserve them."⁵

Cobden's ideas were not idealistic dreams. The United States' industrial strength had revolutionized the world economy and political equilibrium. Cobden: "The new world is destined to become the arbiter of the commercial policy of the old."⁶ Already the need to trade with America had compelled Britain to abandon many regulations governing colonial commerce.

Since free trade and military non-intervention were the same to Cobden, he pleaded for Britain to abandon the past and repeal protectionism. This would make Britain "turn moralist, in the end, in self-defense."⁷

Manchester Incorporation: Prelude to Repeal

Cobden's pamphlets attracted the attention of the editor of the *Manchester Times*, Archibald Prentice, who asked him to speak on free trade issues. This led to Cobden's being elected to the Manchester Chamber of Commerce. Here he met two men who would influence his thinking and direction: John Benjamin "Corn Law" Smith and John Bright. Smith's nickname was due to his years of singlehandedly fighting for Corn Law repeal, long before it became a major topic. It was Smith who converted Cobden to total repeal, not just incremental reductions. John Bright became Cobden's chief lieutenant in the long war for repeal. Bright's speaking tours around the country were a great factor in victory.

Cobden used the Chamber of Commerce as a vehicle for focusing public issues. The first political problem he tackled was the incorporation of Manchester. Like many of England's new industrial cities, Manchester had no borough (an urban political administrative area) charter. Its government was manorial, with the power of a small town, instead of one of England's largest urban centers.

In 1837 Cobden led the battle for a charter. One factor in winning was that he fought for it as if it were a national issue. His pamphlet, "Incorporate Your Borough," portrayed the struggle as one of democracy versus privilege, the rights of the productive classes against the rapacious aristocracy. He showed that the nobility's gerrymandering of counties forced the middle and working classes to be their vassals.

Incorporation required a petition of taxpayers. There was powerful opposition from the upper class Tories. To counter this, Cobden focused on the "shopocracy," the smaller merchants and manufacturers, for petition signatures. Then, using electoral registers, the Incorporationists sent a circular to all parliamentary electors who supported reform causes, to aid them by filling seats at public meetings. They did, and incorporation passed despite the fact that the Tories had three times as many signatures. Cobden made a name-by-name check of the opposition petition and found that 70 percent were invalid. With incorporation, Cobden was elected to his first public offices: borough councilor and alderman.⁸

The Manchester League: Fighting for Free Trade

Cobden now set his sights on an ambitious national goal that had previously proved impossible to attain: repeal of the Corn Laws. In 1838 the Manchester Anti-Corn Law Association (later, the Manchester League) was created. Cobden saw repeal as the greatest single battle of his time. It would unite workers, farmers, and commercial interests against privilege to radically alter the political power structure of the country.

The League's initial goal was to educate the public. Lecturers went all around England, giving free trade conferences. At this stage, political pressure did not seem necessary. But the League did have an ally in Parliament: Charles Villiers. For years he had unsuccessfully tried to initiate a Corn Law repeal debate in the House of Commons, which was dominated by big landlords. However, Cobden knew that Villiers' efforts helped identify supporters at the national level. This would influence the League's strategy in the provinces.

Within the first year Cobden realized that he had underestimated the Protectionists' strength. In rural areas, League meetings were disrupted by physical violence. The farmers erroneously believed that free trade would bring unemployment and depression. The Chartists, representing the urban workers, were hostile for the same reason. Cobden hoped that the League's message would convince both groups that repeal would open up new markets which would raise all wages. It required years of educating for these truths finally to be perceived.

This generated a strategic change: the lectures were now combined with petition drives for Parliament. Thus began overt political activism. By 1840 the Manchester League transformed itself, creating in every borough an anti-Corn Law party, or at least an effort to "prevent the return of any candidate at the next election, whatever his political party may be, who supports . . . the landowner's bread tax."⁹ This meant a more aggressive League, less compromising, less fearful of making enemies.

In 1841, a major economic depression occurred. Suddenly Prime Minister Robert Peel resorted to the free trade idea of lower tariffs to stimulate the economy. This made the Corn Laws nationally significant and gave greater credibility to the League.

By now the League had several members in Parliament, including Cobden. But he was a reluctant member. He did not want to be a "party man," loyal and compromising. He needed to be free to harass the government.

Cobden's speeches in Parliament were not influential and this dampened League

members' enthusiasm. Support dropped sharply. In all mass movements, zeal is critical. There is a constant need to exceed earlier achievements or risk dissolution. So Cobden created "make-work" projects like conferences and fund-raisers to keep the fervor at high pitch.

By 1843, paradoxically, economic recovery made the League acceptable to the one group most antagonistic to repeal: the aristocratic landowners. When times had been bad, high prices and high subsidies compensated for the poor yields. But now, prices kept falling with increased abundance and the Tories saw that the Corn Laws did not shore up their incomes.

Cobden's speeches became more moderate. Instead of attacking the Corn Laws, he attacked the greater evils behind them: the economic woes to workingmen and farmers. The new accent was on distress, not repeal. Now he no longer seemed menacing to the Tories. Gone were the threats of the collapse of society because of high food prices. No longer did he say that the Corn Laws benefited only the rich. He appealed to the landlords themselves, showing them that protective tariffs deterred them from investing to improve their crops, thus hindering their prosperity.

This wider view drew many leading Tories to the repeal side and was responsible for Robert Peel receiving a League delegation after repeatedly turning them down.

This was followed by a new League political plan. All the boroughs were classified as either "safe," "doubtful," or "hopeless." Voter registration focused on the hopeless districts. Teams of lecturers and voter canvassers fanned out and recruited thousands of new members. Cobden's overall objective was staggering: to reach every voter with League material through the canvassers. The sheer scale of it produced more enthusiasm, more fund-raisers, more activities, but it failed and did not destroy the Protectionists. Cobden had the courage to admit he was wrong and turned around completely in mid-campaign, refocusing on the winnable boroughs.

Cobden targeted 160 boroughs as winna-

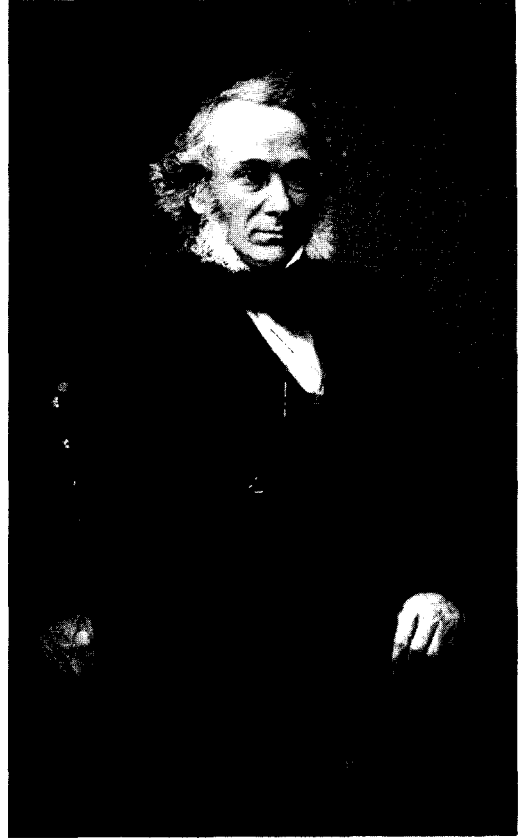
ble. The 1845 national election showed substantial gains in 112. This still wasn't sufficient to win a Parliamentary vote. League members were now thoroughly demoralized. Their tremendous work seemed futile. Then Cobden discovered a loophole in the election law, enabling the League to attack from an entirely different direction. This proved to be the key to victory.

Previously Cobden had conceded the counties (the rural political districts). To win them he would have to create a vast new electorate. This seemed impossible because of the large property qualification required. Or so he thought. But a little-known law made it possible to vote in a county election if one owned a "forty-shilling freehold," a small piece of property that almost anyone could afford. By promoting forty-shilling freeholds as a great real estate investment, the number of free-trade voters was greatly expanded. Immediately the Tories retreated. They acknowledged that protectionism hindered agricultural modernization and conceded that subsidies did not stabilize corn prices.

Seeing that his opponents were caving in, Cobden once again switched the mode of attack: de-emphasizing public education to put more pressure on Parliament. This forced Prime Minister Peel over to the League side, provoking a governmental crisis. He was forced to resign and his government collapsed. Repeal now seemed within reach. But the chaos compelled a Parliamentary re-organization, reflecting the revolutionary change in the balance of power that repeal represented, shifting away from the aristocrats toward the urban middle class. It appeared that the Protectionists had formed a last-ditch coalition to block repeal just when it seemed assured. League members held their breath. Repeal passed Parliament and became law.¹⁰

The Consequences of Repeal

Following repeal, Richard Cobden was physically, mentally, and financially drained. He considered retiring permanently from politics. For the five years prior



Richard Cobden
1804–1865

to repeal he saw very little of his wife and children. "My only boy is five years old . . . he did not positively know me as his father, so incessantly was I upon the tramp."¹¹ Yet Cobden felt the necessity to go on. He saw repeal as a beginning, not an end. More than prosperity, it would bring world peace. He spent the next fourteen months on a missionary tour of Europe, promoting the social benefits of trade without barriers.

He wrote: "Warriors and despots are generally bad economists and they instinctively carry their ideas of force and violence into the civil politics of their governments. Free trade is a principle which recognizes the paramount importance of individual action."¹²

Several years later his evangelism led to the second great triumph of his political career, the Anglo-French Commercial Treaty of 1860. France was still a protectionist country, but Cobden's tour had con-

verted important Frenchmen into free-traders. They had influenced Napoleon III. One such person was Michel Chevalier, a political economist.

For centuries England and France had been military antagonists, but in the Crimean War of 1854–55 they were allies. Through free trade there was a unique opportunity to strengthen the bonds for permanent peace.

Initially there were several secret meetings in London among Chevalier, Cobden, and Gladstone, the Chancellor of the Exchequer. Then Cobden, with no official status, quietly left for Paris. He believed then, as always, that free trade would undo the national animosities kept alive by the professional diplomats and the military. "I would not step across the street just now to increase our trade, for the mere sake of commercial gain . . . But to improve moral and political relations of France and England, by bringing them into greater intercourse and increased dependence, I would walk barefoot from Calais to Paris."¹³

Napoleon realized that he had to convince his own government about the benefits of free trade. He asked Cobden how to go about it. Cobden replied, "I told him, I would act precisely as I did in England, by dealing first with one article which was the keystone of the whole system. In England, that article was corn, in France, it was iron; that I should totally abolish and at once the duty on pig iron, and leave only a small revenue duty, if any, on bars . . . this would render it much easier to deal with all the other industries, whose general complaint is that they can't compete with England owing to the high price of iron and coal."¹⁴

When the negotiations reached their critical phase, Cobden thought he would be replaced by professional diplomats. Instead he was given plenipotentiary powers and continued on his own. The agreement was signed in January 1860.

Cobden's Legacy

Cobden died in April 1865. He was sixty years old. His legacy is enormous and remains so to this day. For eighty-five years free trade reigned as England's national policy, influencing the commercial principles of every major country in the world. Richard Cobden's idealism and passionate dream can be summed up by his statement: "I see in the free trade principle that which will act on the moral world as the principle of gravitation in the universe—drawing men together, thrusting aside the antagonisms of race, and creeds and language, and uniting us in the bonds of eternal peace. . . . I believe the effect will be to change the face of the world, so as to introduce a system of government entirely distinct from that which now prevails. I believe the desire and the motive for large and mighty empires and gigantic armies and great navies . . . will die away . . . when man becomes one family, and freely exchanges the fruits of his labor with his brother man."¹⁵ □

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2. Alexis de Tocqueville, *Journeys to England and Ireland*, edited by J. P. Mayer (New Haven: Yale University Press, 1958), pp. 107–108.

3. John McGilchrist, *Richard Cobden, the Apostle of Free Trade* (New York: Harper & Brothers, 1865), p. 20.

4. Richard Cobden, "Russia," from *The Political Writings of Richard Cobden*, 4th edition (London: W. Ridgway, 1903), p. 26.

5. Cobden, "America," from *Political Writings*, p. 5.

6. Cobden, p. 21.

7. Cobden, p. 256.

8. Nicholas Edsall, *Richard Cobden, Independent Radical* (Cambridge: Harvard University Press, 1986), pp. 51–59.

9. Edsall, p. 85.

10. Edsall, pp. 53–153.

11. Edsall, p. 174.

12. Edsall, p. 186.

13. Edsall, p. 333.

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15. Richard Cobden, *Speeches on Public Policy, By Richard Cobden, M.P.*, edited by John Bright and J. E. Thorold Rogers (London: Macmillan & Co., 1870), pp. 225–226.

OUT OF WORK

by John Chamberlain

After last fall's election George Bush said he beat himself. But history asks of Bush no such abasement. History tells us that when unemployment is high, presidential incumbents always lose.

In a fantastically detailed book called *Out of Work: Unemployment and Government in Twentieth-Century America* (New York: Independent Institute, Holmes and Meier, Foreword by Martin Bronfenbrenner, 326 pages, \$27.95, \$16.95), Richard Vedder and Lowell Gallaway controvert Bush's assessment. I'll take Vedder's and Gallaway's word for it. They seem to know every bit of evidence about unemployment going well back into the nineteenth century. Their conclusion is that government action aimed at eliminating unemployment of more than seven percent defeats itself. The best way, they say, to reduce unemployment is to do nothing.

In 1929, when Herbert Hoover was running things, we had an activist who had fed the Belgians and Russians. He thought he knew everything about stabilizing markets by government interference. The word that went out from the White House was that money wages should not be cut. High wages would maintain purchasing power. The purchasing power fetish, with Hoover's sanction, became the orthodoxy of the time. When Franklin Roosevelt took over, he saw no reason to change things. After all, he had been an activist too.

Simply put, this meant that there was a bottom rigidity to a key factor of production. The free market was not allowed to work.

To force things, deficit financing was resorted to in various combinations. The

National Industrial Recovery Act set prices under the so-called Blue Eagle until the Supreme Court invalidated it, but this was by no means the end of the high-wage story. The Wagner Act, the Social Security Act, the Fair Labor Standards Act, all contributed to maintaining high labor costs. The Smoot-Hawley tariff added a protectionist bias that provoked foreign retaliation. American employers went along with Franklin Roosevelt (Ford and Thomas Edison were with them), but only up to a point. When a person could not earn the minimum wage he was understandably jettisoned.

Quoting from a *National Review* summary of their book, Vedder and Gallaway say that "market forces tend to end recessions naturally by forcing a fall in the adjusted real wage . . ." The 1920-21 recession, infinitely worse at the outset than the Great Depression, dissipated itself within a year under "do nothing Presidents" (Woodrow Wilson was too seriously ill to pursue his natural inclinations, and Warren Harding wasn't interested).

The Great Depression, by contrast to that of 1920-21, got worse after continual market meddling. More recently, the 1982 recession lasted only about a year, with no special attempt on the part of the Reagan Administration to end it. As labor markets softened, real wages fell.

Vedder and Gallaway take four vivid impressions from reading American macroeconomic history. One is that the worker needs prosperous capitalists to provide for job opportunities. The second is that government efforts to reduce unemployment must worsen the problem. The third is that

long-term improvement in living standards requires improvements in productivity, better understood by reading Adam Smith than John Maynard Keynes. The fourth impression is that "experts" are dangerous and should be listened to skeptically. Being "kinder and gentler" by approving a morass of new environmental, civil rights, minimum wage, and other legislations has hurt American workers. The "experts" are to blame.

As they keep reiterating, Vedder and Gallaway are bent on keeping government out of it. They pound this in: the best thing to do in dealing with unemployment is to leave it alone. □

Pride, Prejudice, and Politics: Roosevelt Versus Recovery, 1933–1938

by Gary Dean Best

New York: Praeger, 1991 • 267 pages • \$45

Reviewed by C. Lowell Harriss

This study documents President Franklin D. Roosevelt's hostility to business. In his 1933 inaugural address he spoke of the "plenty . . . at our doorstep" whose "generous use . . . languishes because rulers of the exchange of mankind's goods have failed through their own stubbornness and their own incompetence, have admitted their failure, and have abdicated." As the months and years passed, business leaders could see that such antagonism was not merely political hyperbole. FDR gave every indication of believing what he had said. So did persons close to him.

To help in the campaign of 1932 FDR's advisers had recruited a "brain trust" from academia (chiefly Columbia University). "Only men . . . who could come to the many conferences . . . on a five cent fare" wrote Judge Rosenman, the recruiter. The economist, Professor Rexford Guy Tugwell, had just published an article decrying the profit motive.

The inauguration brought no substantial program for recovery. Throughout the pe-

riod covered by this book (to 1938) reform seemed to take precedence over recovery as the key concern of persons close to FDR.

This scholarly, well-documented study—there are 1055 endnotes—makes a convincing case that FDR's prejudices, antipathies based on emotion, worked against recovery. Despite evidence of the willingness of business leaders to cooperate in the early months, the President's suspicions continued. "Businessmen who headed giant corporations were belittled . . . by Roosevelt for lack of intelligence."

Recovery of the economy would be recovery of business. And business recovery would depend, in part at least, upon the beliefs and expectations, the "animal spirits," of heads of businesses. Although one can never know how different the record would have been if FDR had not been so antagonistic, the author believes, I think correctly, that Americans suffered needlessly from FDR's antipathies.

The policies of the first four New Deal years failed to produce sustained recovery. The economy suffered a serious and quite unexpected decline late in 1937. Treasury Secretary Henry Morgenthau informed the President in a telephone conversation on November 3, 1937, that another serious depression was under way and that the Federal Reserve should do something. Morgenthau recorded at the time: "From then on the President got very excited, very dictatorial and very disagreeable."

He quoted at great length a man whom he described as a "wise old bird" who had told him that there were 2,000 men in this country who had made up their minds that they would hold a pistol to the President's head and make certain demands of him, otherwise they would continue to depress business. He quoted a lot of other generalities.

I [Morgenthau] said, "A great deal depends on who this person is" and like a crack from a whip he said, "It is not necessary for you to know who that person is," which led me to believe that the "wise old bird" was himself . . .

Did the President really believe in such a conspiracy? Could such a thing possibly have been kept secret then or since?

FDR's repeated refusals to accept and take seriously business leaders' efforts to cooperate must have aggravated their alienation resulting from opposition to what the New Deal called reforms. Some advisers were unsuccessful in convincing the President that many of his policies on taxation, securities regulation, labor union organization, and so forth discouraged investment and business recovery.

The evidence in this study of FDR's continuing anti-business allegations—one quotation after another, year after year—must convince the reader that something quite irrational influenced him profoundly.

The author, Professor of History at the University of Hawaii at Hilo, does not presume to present a complete history of the first five years of the New Deal. But no history of the period can be complete without taking account of the evidence in this study. The closing chapter presents a picture that supports the assessments of contemporary observers, some certainly of unquestioned stature, who found "pettiness and spitefulness" in FDR, a person "who was intolerant of criticism and critics, and who grasped for dictatorial power" The Roosevelt of the pre-World War II years does not, the author believes, rank among the great presidents. □

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Capital Ideas: The Improbable Origins of Modern Wall Street

by Peter L. Bernstein

The Free Press, 340 pages, \$24.95

Reviewed by Raymond J. Keating

Peter Bernstein documents in workmanlike fashion not only the unusual intellectual origins of many modern financial instruments and strategies, but also how

financial economists have struggled to gain the full acceptance of their economic brethren. Finance was long neglected by economists. The author gently, yet at times unevenly, mixes personal anecdotes about individuals—including not only economists but engineers and physicists as well—with an interesting overview of their contributions to the theory of finance.

The genesis of modern financial innovations largely came from cloistered academics with little securities market experience, rather than from street-smart analysts and investors, for example. In fact, modern developments in finance spring from a central tenet not often accepted by such securities professionals. The overarching theme of *Capital Ideas* is that securities markets are efficient. Efficient financial markets seemingly present a conundrum for securities analysts and investors. On the one hand, market efficiency largely condemns the analysis profession to futility. That is, if markets are efficient, with prices immediately reflecting all information, one cannot regularly "beat the market." However, without hard-working and talented securities analysts and investors seeking out new information, the markets would not be so efficient. Bernstein points out that efficient securities markets and the concomitant fact that most investors will do no better than average is actually "a compliment to the avidity and intelligence and self-interest that motivate informed investors. If more investors were to become less zealous in pursuit of their fortunes, the keen and the swift would find the market a lot easier to beat."

Bernstein examines several innovations in finance theory, from Harry Markowitz's development of the "Efficient Frontier" of securities portfolios to Hayne Leland's idea for insuring such portfolios. James Tobin's "Separation Theorem," William Sharpe's development of the "Capital Asset Pricing Model," Eugene Fama's "Random Walk Theory," Modigliani and Miller's assertions that the market value of the firm is independent of its capital structure, and Black and Scholes' analysis of option pricing are all surveyed to varying degrees.

Two aspects of Bernstein's book are particularly intriguing however. Ironically, the first is his closing chapter. All authors seek to neatly tie together the themes and ideas strewn throughout their books in the final chapter. Bernstein does so splendidly. He takes the many financial innovations explained in the preceding fourteen chapters, and expresses their importance to everyday economic life.

Bernstein illuminates the critical role financial markets play in economic development and growth, a point of particular importance today as socialism continues its descent. In fact, the author unequivocally declares: "In socialist economies it is the absence of free and active markets for corporate ownership that deprives citizens of the goods they want, with the quality they demand, and at the prices they can afford." Without functioning financial markets, resources are misallocated with "catastrophic effects on living standards, employment and economic growth."

The importance of risk-taking does not elude the author's purview. Bernstein observes: "Because the stock market makes diversification easy and inexpensive, the average level of risk-taking in society is enhanced." And very simply, "Institutions that encourage risk-taking are essential if a society is to grow and raise its living standards."

Bernstein also describes how theoretical

innovations met specific, "real world" needs. For example, the "markets for futures and options allow dealers to hedge the risks they incur," and the junk bond market "satisfied the needs of both the investors who bought junk bonds and the relatively small companies" seeking much needed capital for growth and job creation "that their banks either could not or would not supply."

The second intriguing aspect of *Capital Ideas* is buried between the lines. Several of the economists Bernstein discusses, such as James Tobin, Paul Samuelson, and Franco Modigliani, are Keynesian macroeconomists. Yet, the truly interesting aspects of their life's work have been accomplished on the micro-level, for example, verifying the efficiency of securities markets and exploring its implications. One can only imagine what these individuals might contribute if they would finally let go of their fallacious macroeconomic analysis and prescriptions, such as fine tuning aggregate demand, and apply their intellects and microeconomic analytical tools to issues like economic growth, taxation, employment, and living standards. The dichotomy between the microeconomic and macroeconomic endeavors of such individuals is apparent to many, except themselves and others schooled in the failed Keynesian system. □

Raymond J. Keating is New York State Director of Citizens for a Sound Economy.

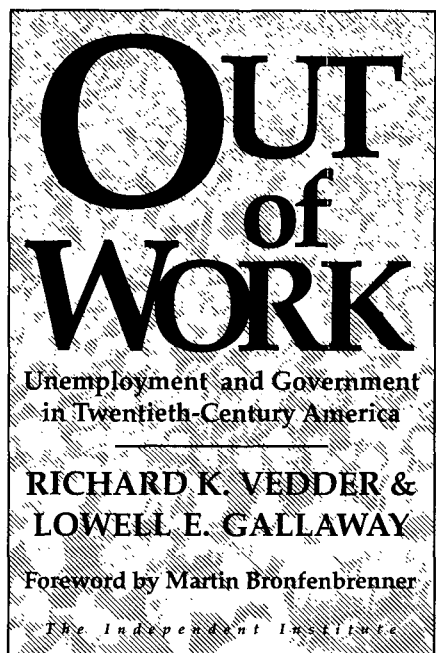


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